HBOS plc

Report and Accounts

2022

Member of Lloyds Banking Group

Contents

Strategic report

Principal activities

HBOS plc (the Company) and its subsidiaries (together, the Group) provide a wide range of banking and financial services.

The Group's revenue is earned through interest and fees on a broad range of financial services products including current and savings accounts, personal loans, credit cards and mortgages within the retail market and loans and other products to commercial and corporate customers.

Business review

Income statement

The Group's profit before tax for the year was £1,209 million, £1,062 million lower than 2021. The benefit of lower operating expenses was more than offset by the effects of lower income and an impairment charge (compared to a credit in the prior year), in part reflecting the deterioration in the economic outlook. Profit after tax was £1,140 million (2021: £1,844 million, which included the benefit of a deferred tax remeasurement).

Total income for the year was £4,992 million, a decrease of 13 per cent on 2021, as the continued recovery in customer activity and interest income benefits from UK Bank Rate changes were more than offset by higher funding costs.

Net interest income was £4,581 million in 2022, compared to £5,386 million in 2021. This was driven by higher funding costs on amounts due to fellow Lloyds Banking Group undertakings which more than offset the effects of average interest-earning asset growth and interest income benefits from UK Bank Rate increases.

Other income was £411 million in 2022, compared to £361 million in 2021. Fee and commission income of £615 million was up from £563 million in 2021 reflecting the impact of improved current account and credit card performance. Net trading income was relatively stable at £59 million and other operating income was up £28 million, reflecting higher levels of recharges to fellow Lloyds Banking Group undertakings.

Operating expenses decreased by £697 million, or 18 per cent to £3,153 million in 2022 compared with £3,850 million in 2021. Other expenses were £586 million, or 26 per cent, lower at £1,690 million in 2022 compared with £2,276 million in 2021, driven by the decrease in charges for regulatory and legal provisions. Depreciation and amortisation costs were £60 million, or 21 per cent, lower at £224 million in 2022 compared to £284 million in 2021, reflecting the significant software asset write-off in 2021 as a result of investment in new technology and systems infrastructure. Staff costs were £83 million, or 7 per cent, lower at £1,066 million in 2022 compared with £1,149 million in 2021. Partly offsetting these decreases, premises and equipment costs were £32 million higher at £173 million in 2022 compared with £141 million in 2021.

The impairment charge of £630 million in 2022, compared to a net credit of £374 million in 2021, reflected strong observed credit performance, but was impacted by a deteriorating economic outlook partly offset by COVID-19 releases. Asset quality remains strong, with sustained low levels of new to arrears and very modest evidence of deterioration in observed credit metrics despite the inflationary pressures on affordability during the latter half of the year. The Group's ECL allowance increased in the year by £686 million to £3,324 million, compared to £2,638 million at 31 December 2021. Overall the Group's loan portfolio continues to be well-positioned, reflecting a prudent through-the-cycle approach to lending with high levels of security, also reflected in strong recovery performance.

The Group recognised a tax expense of £69 million in the year, compared to a tax expense of £427 million in 2021. The tax expense in 2022 included a £222 million benefit in relation to the tax deductibility of provisions made in 2021, and a £10 million benefit (2021: £420 million benefit) arising on the remeasurement of deferred tax assets.

The Group's post-tax return on average total assets decreased to 0.34 per cent compared to 0.56 per cent in the year ended 31 December 2021.

Balance sheet

Total assets were £9,448 million, or 3 per cent higher at £319,567 million compared to £310,119 million at 31 December 2021. Financial assets at amortised cost were £11,977 million higher at £306,669 million compared to £294,692 million at 31 December 2021. Loans and advances to customers increased to £292,416 million, as a result of growth in the Group's mortgage book and the acquisition of MBNA Limited, formerly a subsidiary of Lloyds Bank plc. Also within financial assets at amortised cost, amounts due from fellow Lloyds Banking Group undertakings were £1,199 million lower. Financial assets at fair value through other comprehensive income decreased £2,076 million due to disposals in the year. Goodwill and other assets both increased in 2022 due to the acquisition of MBNA Limited.

Total liabilities were £7,615 million higher at £302,145 compared to £294,530 million at 31 December 2021. Customer deposits were £4,414 million lower at £166,363 million at 31 December 2022 compared to £170,777 million at 31 December 2021. Amounts due to fellow Lloyds Banking Group undertakings increased by £13,391 million in the year. In addition, there was a decrease in debt securities in issue of £1,230 million due to a reduction in securitisation and covered bond programmes.

Total equity increased from £15,589 million at 31 December 2021 to £17,422 million at 31 December 2022, largely as a result of the Group's profits, capital contributions received of £1,100 million, which funded the acquisition of MBNA Limited, and the issuance of ordinary shares of £600 million. These were partially offset by the impact of pension scheme remeasurements given market conditions and distributions to non-controlling interests.

Capital

Neither the Company nor the Group are regulated from a capital perspective. Regulatory capital is instead managed in the Company's principal banking subsidiary, Bank of Scotland plc.

Future developments

Information about future developments is provided within the principal risks and uncertainties section below.

Section 172(1) Statement

In accordance with the Companies Act 2006 (the 'Act'), 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 detail on key stakeholder interaction is also included within the directors' report on pages 7 to11.

The directors remain mindful in all their deliberations of the long-term consequences of their decisions, as well as the importance of the Company maintaining a reputation for high standards of business conduct and the board of directors (the 'Board') engaging with, and taking account of the views of, key stakeholders.

Key Stakeholder Engagement

As in 2021, the non-executive directors undertook a tailored engagement programme which allowed them to hear directly from their key stakeholders, including customers, clients and colleagues.

The programme was designed to help the directors better understand what matters in the lives of customers and colleagues, the role the Company plays in supporting them and how the Company is performing in that regard, in turn helping to inform the directors' decision making.

A variety of activities took place under the programme, including meetings with customers and clients and conversations with colleagues, to understand the matters which are most important in their lives, both at and outside work, and the challenges these stakeholders face as the external economic environment continues to evolve. The non-executive directors found these sessions to be of great benefit, providing many valuable insights which helped in their review of the proposals considered by the Board during the year.

Our Stakeholders

Customers and clients

The Board has an ongoing commitment to understanding and addressing customer and client needs, which remains central to achieving the Company's strategic ambitions.

Examples of Board engagement with customers and clients included:

- Dedicated updates from across the organisation, which identified areas of customer and client concern, covering a range of internal and external performance measures; in addition, concerns relevant to customers and clients were identified for consideration in wider proposals put to the Board
- Regular updates giving insight into the Company's performance in delivering on its customer and client related objectives and commitments, assisting in determining where further action was required to meet these objectives
- The Chair and the Group Chief Executive attended customer and client engagement events, across all main regions of the UK, providing an important opportunity for customers and clients to raise their concerns directly with these Board members
- Non-executive directors attended special events to provide a deeper insight into the issues which customers and clients have faced during the year, which included sessions on the challenges of buying and owning a home, the practical issues faced as a consequence of the cost of living crisis, the challenges customers face in day to day family life, and the issues which our commercial and SME clients are routinely facing

Shareholders

The Company is a wholly owned subsidiary within the Lloyds Banking Group group of companies. The directors ensure that the strategy, priorities, processes and practices of the Company are fully aligned where required to those of Lloyds Banking Group, ensuring that the interests of Lloyds Banking Group as the Company's sole shareholder are duly acknowledged. Further information in respect of the relationship of Lloyds Banking Group with its shareholders is included within the strategic report within the Lloyds Banking Group Annual Report and Accounts for 2022, available on the Lloyds Banking Group website.

Colleagues

Colleagues remain a vital part of the delivery of the Company's strategic ambitions, and the Board continues to recognise this in its engagement with colleagues, which has again this year included a variety of sessions across the Group, to discuss topical issues relating to challenges at and outside work.

Following a review in 2021 of how the Board engages with the Company's workforce, the Board's Responsible Business Committee has continued to be the designated body for workforce engagement, providing focus, but with the Board also retaining a commitment for individual Board members to continue to engage with colleagues directly throughout the year. The Board considers these arrangements to be effective as they enable a broad range of colleague engagement activities, as described in this section.

The Responsible Business Committee reports regularly to the Board on all of its activities, including on its colleague engagement agenda. The Board will continue to consider its arrangements for engaging with the Company's workforce to ensure they remain effective, and encourage meaningful dialogue between the Board and colleagues.

Examples of engagement with colleagues included:

- Regular review by the Responsible Business Committee of workforce engagement reports, covering key issues raised by colleagues, trends on people matters and updates on colleague sentiment
- Review by the Responsible Business Committee of the findings of surveys of colleague sentiment and views, including annual and ad hoc surveys, and review of the progress being made in addressing the matters colleagues have previously raised
- A related annual report to the Board, summarising all colleague engagement activity, key themes and issues which colleagues have raised during the year
- Non-executive directors attended a number of colleague focus groups to discuss themes from the annual colleague survey, the Company's new strategy and values, pay and reward and hybrid working. They also attended sessions where they were able to observe colleagues at work, including Fraud team colleagues handling customer calls
- The approach to colleague surveys will continue to evolve in the coming year, with insight from monthly 'Pulse' surveys being used to inform the discussion topics for future non-executive director / colleague focus groups
- Town Hall sessions were hosted by both the Chair and the Group Chief Executive, complemented by engagement sessions led by other senior leaders with feedback shared with the wider Board. The Group Chief Executive also held sessions with colleagues from a number of specific business areas across the Company
- Board members attended a range of other events held for the Company's senior leaders and other colleague network events

During the year the Company communicated directly with colleagues detailing Company performance, changes in the economic and regulatory environment and updates on key strategic initiatives. Meetings were held throughout the year with our recognised unions.

For 2022, the Lloyds Banking Group Remuneration Committee approved Group Performance Share awards for colleagues, and colleagues are eligible to participate in HMRC approved share plans which promote share ownership by giving employees an opportunity to invest in Lloyds Banking Group shares.

Society and environment

The Board places great importance on engagement and action to help the communities in which the Company operates in prosper, while helping to build a more sustainable and inclusive future.

Relevant engagement included:

- Updates on climate, environmental and social matters, covering all aspects of the Company's business, where the Board reviewed progress made against stated ambitions in these areas, and agreed any further action it considered was required
- The Board continues to be supported in environmental matters by its Responsible Business Committee. The committee considers stakeholder views on all matters relating to the Company's ambition to be a trusted, sustainable, inclusive and responsible business

Regulators and government

The Board continues to maintain strong and open relationships with the Company's regulators and with government authorities, including key stakeholders such as the FCA, the PRA, HM Treasury and HMRC.

Relevant engagement included:

- The Chair and individual directors, including Chairs of the Board's committees, held continuing discussions with the FCA and the PRA on a number of aspects relevant to the evolving regulatory agenda
- The Board regularly reviewed updates on wider Company regulatory interaction, providing a view of key areas of focus, and also progress made in addressing key regulatory priorities
- A meeting was held between the Board and the PRA in July to discuss the outcomes and progress of action relevant to the PRA's Periodic Summary Meeting letter

Suppliers

The Company has a number of partners it relies on for important aspects of our operations and customer service provision, and the Board recognises the importance of these supplier relationships in achieving the Company's wider ambitions.

Engagement with suppliers included:

- The Board's Audit Committee considered reports from the Sourcing and Finance teams on the efficiency of supplier payment practices, including those relating to the Company's key suppliers, ensuring our approach continued to meet wider industry standards
- The Board continued to oversee resilience in the supply chain, ensuring our most important supplier relationships were not impacted by potential material events
- The Board has an ongoing zero tolerance approach towards modern slavery in our supply chain, and receives updates on ongoing enhancements to supplier practices, including measures to address the risk of human trafficking and modern slavery in our wider supply chain

Key Decisions

Significant stakeholder engagement takes place at all levels within the organisation. Managing stakeholder interest is an important focus for the Board, and forms a key part of the Board's delegation of the day to day management of the business to the executive.

In addition to the direct engagement of Board members with stakeholders discussed on pages 2 to 3, the Board requires the stakeholder implications of all proposals submitted to it from across the organisation to be considered, with stakeholder interests identified by the executive in these proposals, both within the papers and as part of the accompanying presentations.

Through their regular business updates, and in their other interactions with the Board outside of the board room, the executive routinely provide the Board with details of stakeholder interaction and feedback from across the wider organisation. Throughout 2022 the Board's key stakeholders remained the same as they were in 2021.

The directors remain mindful in all their deliberations of the long-term consequences of their decisions, as well as the importance of the Company maintaining a reputation for high standards of business conduct and the Board engaging with, and taking account of the views of, key stakeholders.

Strategy

Customers & Clients, Colleagues, Society & Environment

Lloyds Banking Group announced in February 2022 its ambitious new strategy, which included the strategy for the Company. While the external environment has changed significantly since then, the strategy remains the right one given its continued focus on customers whilst delivering growth and diversification. The Board ensures that the necessary resources are in place for the organisation to meet its objectives and measure performance against them, and the focus of the Board on supporting the implementation of the strategy remains strong.

Given the fundamental importance of the Group's delivery of its strategy, the Board considered aspects of implementation of the strategy including opportunities and risks to delivery at its scheduled meetings in 2022.

Additionally, the Board held dedicated sessions in June and November where progress against the strategy was a primary focus. In June this included discussion of developments in key business areas, progress on the path to net zero, and updates on initiatives supporting the implementation of the strategy, including the mobilisation of the new platform-based operating model.

The Board provided valuable feedback to the executive leadership team, which was considered and acted upon, with further updates provided at Board meetings later in the year, and at the dedicated session in November.

At its November session, the Board also considered the impacts on the strategy of the changing economic environment, changes in the skills the Company will need as the strategy develops, and the importance of purpose in delivering on agreed strategic ambitions and how the Company delivers sustainable long term success.

Stakeholder interest was at the forefront in all these discussions. This was drawn out by the executive, including how the implementation and development of the strategy is impacting both customers and colleagues, with the Board reflecting on feedback received from stakeholders on progress in implementing the strategy.

Culture, Values and Purpose

Customers & Clients, Colleagues, Society & Environment

The Board continues to recognise the importance of creating a purpose-driven culture led by values which drive the delivery of the right outcomes for the Company's stakeholders. The Board has to that end continued to oversee the activity commenced in 2021 to deliver transformation in this area.

The Board considered early in the year the importance of the Company's values as a driver to wider cultural change, and in that regard agreed proposals for re-defining these values, and for providing fuller alignment between values and its purpose, recognising that both of these are key drivers of our cultural change.

The Board encouraged feedback to be sought from colleagues on the values proposed, and following this feedback approved a re-launch and programme of colleague engagement.

The purpose remains aligned to that of Lloyds Banking Group in Helping Britain Prosper, and the new five values are People-first, Bold, Inclusive, Sustainable and Trust. The Board then considered progress in the embedding of purpose and the re-defined values. This included how the Lloyds Banking Group Culture Plan would deliver on the ambitions which had been set, how the Company would know that progress was being made, and the areas and actions which would take particular focus during the course of the year, while also ensuring that simplicity could be maintained in the overall approach.

Later in the year the Board endorsed a new framework to enable the delivery of further cultural change, including new initiatives such as the Grow with Purpose leadership development programme. The Board will continue to review progress in this area in the year to come.

Climate and Net Zero

Society & Environment, Colleagues, Customers & Clients, Shareholders, Suppliers, Regulatory & Government

The Board has overall oversight of environmental, social and governance matters, with sustainability an integral element of the Company's strategy and embedded in business objectives. The Board maintains its commitment to, and acknowledges the importance of, the ambitious climate change goals set for Lloyds Banking Group in 2020, including the Company, including reducing emissions financed by more than 50 per cent by 2030, and achieving net zero by 2050 or sooner.

The Board has devoted considerable time to reviewing progress against these objectives, and during the year oversaw a number of additional commitments to further drive progress to deliver on climate ambitions. Key for 2022 was the release of Lloyds Banking Group's net zero activity update that included sector-specific emission reduction targets for seven Net-Zero Banking Alliance sectors. In October, the Board approved new sector targets for four high emitting sectors, including UK residential mortgages, Automotive original equipment manufacturers and Aviation, along with an update to Power. These combine with existing sector targets for Thermal Coal, Oil and Gas and Retail Motor, with our seven targets now covering some of the UK's hardest to abate and most material sectors.

As part of the process of determining and setting these sector targets, the Board reviewed and challenged key strategic levers, dependencies, risks and opportunities at its offsite meeting in June, acknowledging the unique factors at play within the individual sectors. Alongside sector targets, a new supply chain ambition was agreed to reduce the emissions from suppliers by 50 per cent by 2030 on the path to net zero by 2050 or sooner, complementing existing financed emissions and own operations emissions reduction ambitions. The Board also approved via its Responsible Business Committee enhancements to external sector statement for Oil and Gas.

Progress against all of these initiatives continues to be closely monitored by the Board. As the Group's climate ambitions and related stakeholder interests have been a key consideration for the Board during the course of the year, further information on our progress in meeting climate ambitions and our transition plans can be found in the supplementary Lloyds Banking Group Environmental Sustainability Report 2022.

Principal risks and uncertainties

The significant risks faced by the Group are detailed below.

2022 has seen the Group continue to provide support for its customers amid the backdrop of supply pressures, cost of living increases and global and domestic economy uncertainty.

Observed credit performance remains stable, with very modest evidence of deterioration. The Group's loan portfolio continues to be well-positioned and heightened monitoring is in place to identify signs of affordability stress.

The Group's strategy will see ongoing investment in technology, driving the evolution of processes and further strengthening of the Group's operational resilience, amid continuously evolving threats, such as cyber risk.

Climate change remains a key consideration for the Group, with positive progress in 2022 and a commitment to continued focus in 2023.

Overall, key risks continue to be managed effectively and the Group is well positioned to safely progress its strategic ambitions.

The Group's principal risks and uncertainties are reviewed and reported regularly to the Board of Lloyds Banking Group in alignment with Lloyds Banking Group's enterprise risk management framework.

Capital

Capital risk is defined as the risk that an insufficient quantity or quality of capital is held to meet regulatory requirements or to support business strategy, an inefficient level of capital is held or that capital is inefficiently deployed across Lloyds Banking Group.

Change/execution

Change/execution risk 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 operate within Lloyds Banking Group's risk appetite.

Climate

Climate risk is defined as the risk that the Group experiences losses and/or reputational damage, either from the impacts of climate change and the transition to net zero, or as a result of the Group's responses to tackling climate change.

Conduct

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.

Credit

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).

Data

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.

Funding and liquidity

Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

Market

Market risk is defined as the risk that the Group's capital or earnings profile is affected by adverse market rates or prices, in particular interest rates and credit spreads.

Model

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.

Operational

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational resilience

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 fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

People

People risk is defined as 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.

Regulatory and legal

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.

Strategic

Strategic risk is defined as the risk which results from: incorrect assumptions about internal or external operating environments, failure to understand the potential impact of strategic responses and business plans on existing risk types and failure to respond or the inappropriate strategic response to material changes in the external or internal operating environments.

Strategic report

Financial risk management objectives and policies

Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in notes 35 and 38 to the accounts. The Group's approach to risk management including risk policies, risk appetite, measurement bases and sensitivities, in particular for credit risk, market risk and liquidity risk, is aligned to those of Lloyds Banking Group plc, the Company's ultimate parent. Further information can be found in the Lloyds Banking Group plc Annual Report and Accounts.

The Group maintains risk management systems and internal controls relating to the financial reporting processes designed to:

- ensure that accounting policies are appropriately and consistently applied;
- enable the calculation, preparation and reporting of financial outcomes in line with applicable standards; and
- ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements.

The 2022 Strategic report has been approved by the Board of Directors.

On behalf of the Board

Robin Budenberg
Chair
HBOS plc
7 March 2023

Directors' report

Results

The consolidated income statement on page 24 shows a statutory profit before tax for the year ended 31 December 2022 of £1,209 million (year ended 31 December 2021: £2,271 million).

Dividends

The Company did not pay any interim dividends during the course of the year (2021: £500 million). The directors have not recommended a final dividend for the year ended 31 December 2022 (2021: £nil).

Post balance sheet events

There were no material post balance sheet events.

Going concern

The going concern of the Company and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital.

In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the directors have reviewed the Company and the Group's operating plan and its funding and capital positions, including a consideration of the implications of climate change. The directors have also taken into account the impact of further stress scenarios.

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.

Corporate Governance Statement

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) (the 'Regulations'), for the year ended 31 December 2022, the Company has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the 'Principles'), which are available at www.frc.org.uk. The following section explains the Company's approach to corporate governance, and its application of the Principles.

High standards of corporate governance are central to achieving the strategy which has been set for the Company. To this end a Corporate Governance Framework is in place for Lloyds Banking Group, the Company, Lloyds Bank plc and Bank of Scotland plc, with all four companies sharing a common approach to governance. The framework is designed to meet the specific needs of each company, setting the approach and standards in respect of the Company's corporate governance practices, including addressing the matters set out in the Principles.

This includes the matters reserved to the Board, and the matters the Board has chosen to delegate to management. Governance arrangements, including the Corporate Governance Framework, are reviewed at least annually to ensure they remain fit for purpose. The Board delegates further responsibilities to the Group Chief Executive, who is supported by the Group Executive Committee, the composition of which is detailed on pages 76 to 77 of the Lloyds Banking Group Annual Report and Accounts for 2022. The Corporate Governance Framework of the Company further addresses the requirements of the Principles as discussed below.

Principle One – Purpose and Leadership

The Board is collectively responsible for the long term success of the Company. It achieves this by agreeing the Company's strategy, within the wider strategy of Lloyds Banking Group, and overseeing delivery against it. The Company's strategy is discussed further in the strategic report. The Board also assumes responsibility for the management of the culture, values and wider standards of the Company, within the equivalent standards set by Lloyds Banking Group. The Board's understanding of stakeholders' interests is central to these responsibilities and informs key aspects of Board decision making, as discussed within the statement on pages 3 to 4.

Acknowledging the needs of all stakeholders is fundamental to the way the Company operates, as is maintaining the highest standards of business conduct, which is a vital part of the corporate culture. The Company's approach is further influenced by our purpose to Help Britain Prosper, providing not only outstanding service to our customers, but also responding to the UK's social and economic issues. To this end, the Board plays a lead role in establishing, promoting, and monitoring the Company's corporate culture and values, with the Corporate Governance Framework ensuring such matters receive the level of prominence in Board and executive decision making which they require. The Company's corporate culture and values align to those of Lloyds Banking Group, which are discussed in more detail on page 84 to 85 of the Lloyds Banking Group Annual Report and Accounts for 2022.

Principle Two – Board Composition

The Company is led by a Board comprising a non-executive chair, independent non-executive directors and executive directors, further details of current the directors can be found on page 11. The Board reviews its size and composition regularly and is committed to ensuring it has the right balance of skills and experience, with in respect of diversity, the Board meeting the recommendations of the Parker Review and aiming to meet all recommendations set out in the FTSE Women Leaders Review. The Board considers its current size and composition is appropriate to the Company's circumstances. 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 overall.

The Board is supported by its committees, the operation of which are discussed below, which make recommendations to the Board on matters delegated to them. Each committee has written terms of reference setting out its delegated responsibilities. Each committee comprises non-executive directors with appropriate skills and experience and is chaired by an experienced chair. The committee Chairs report to the Board at the next Board meeting. The Board undertakes an annual review of its effectiveness, which provides an opportunity to consider ways of identifying greater efficiencies, ways to maximise strengths and highlights areas of further development. An externally facilitated evaluation of the Board's effectiveness was undertaken during the course of the year, which concluded that the Board is adding value, with appropriate engagement and focus, a shared strategic perspective and significant attention to risk and control. Further information on conclusions of the evaluation can be found on page 89 of the Lloyds Banking Group Annual Report and Accounts for 2022.

Principle Three – Director Responsibilities

The directors assume ultimate responsibility for all matters, and along with senior management are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation through the Corporate Governance Framework. Policies are also in place in relation to potential conflicts of interest which may arise. All directors have access to the services of the company secretary, and independent professional advice is available to the directors at the expense of Lloyds Banking Group, where they judge it necessary to discharge their duties as directors.

The Board is supported by its committees which make recommendations on matters delegated to them under the Corporate Governance Framework. The management of all committees is in keeping with the basis on which meetings of the Board are managed, with open debate, and adequate time for members to consider proposals which are put forward. The Chair of the Board and each Board committee assumes responsibility with support from the company secretary for the provision to each meeting of accurate and timely information.

Principle Four – Opportunity and Risk

The Board oversees the development and implementation of the Company's strategy, within the context of the wider strategy of Lloyds Banking Group, which includes consideration of all strategic opportunities. The Board is also responsible for the long term sustainable success of the Company, generating value for its shareholders and ensuring a positive contribution to society. The Board agrees the Company's culture, purpose, values and strategy, within that of Lloyds Banking Group, and agrees the related standards of the Company, again within the relevant standards of Lloyds Banking Group. Further specific aims and objectives of the Board are formalised within the Corporate Governance Framework, which also sets out the matters reserved for the Board.

Strong risk management is central to the strategy of the Company, which along with a robust risk control framework acts as the foundation for the delivery of effective management of risk. The Board agrees the Company's risk appetite and ensures the Company manages risk effectively, delegating related authorities to individuals through the Corporate Governance Framework and the further management hierarchy. Board level engagement coupled with the direct involvement of senior management in risk issues ensures that escalated issues are promptly addressed, and remediation plans are initiated where required. The Company's risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of Lloyds Banking Group, and as such are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Company's principal risks are discussed further on page 5.

Principle Five – Remuneration

The Board, informed by the Remuneration Committee of Lloyds Banking Group (the 'Remuneration Committee'), assumes responsibility for the Company's approach to remuneration. This includes reviewing and making recommendations on remuneration policy as relevant to colleagues employed by the Company. The activities of the Remuneration Committee extend to matters of remuneration relevant to subsidiaries of the Company, where such subsidiary does not have its own remuneration committee. Certain members of the Lloyds Banking Group Executive, including the Group Chief Executive, are authorised to act upon the decisions made by the Remuneration Committee, and to undertake such other duties relevant to remuneration as delegated to them.

Principle Six – Stakeholders

The Company as part of Lloyds Banking Group operates under Lloyds Banking Group's wider approach to responsible business, which acknowledges that the Company has a responsibility to help address the economic, social and environmental challenges which the UK faces, and as part of this understand the needs of the Company's external stakeholders, including in the development and implementation of strategy.

Central to this is Lloyds Banking Group's and the Company's purpose of Helping Britain Prosper. During the year there was particular focus on the deterioration in the UK's economic outlook, in particular in the second half of the year. This involved considering the viewpoints of many of the Board's key stakeholders, to determine how the Company could best support the recovery, the approach which was ultimately taken being set out on pages 22 to 31 of the Lloyds Banking Group Annual Report and Accounts for 2022.

Directors' report

In 2022 the Responsible Business Committee provided further oversight and support of Lloyds Banking Group's and the Company's plans for embedding responsible business in the Company's core purpose. The approach of the Board in respect of its key stakeholders is described further in a separate statement made in compliance with the Regulations on pages 2 to 4.

Directors

The names of the current directors are shown on page 11. Changes to the composition of the Board since 1 January 2022 up to the date of this report are shown in the table below.

	Joined the Board	Left the Board
Scott Wheway	1 August 2022	
Cathy Turner	1 November 2022	
Stuart Sinclair		12 May 2022

Directors' indemnities

The directors of the Company, including the former director who retired during the year, have entered into individual deeds of indemnity with Lloyds Banking Group plc which constitute '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 2022. In addition, Lloyds Banking Group plc had appropriate directors' and officers' liability insurance cover in place throughout 2022. Deeds for existing directors are available for inspection at the Company's registered office.

Lloyds Banking Group plc 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 former directors who retired during the year, and to colleagues subject to the provisions of the Senior Managers and Certification Regime. Such deeds were in force during the financial year ended 31 December 2022 and remain in force as at the date of this report. Qualifying pension scheme indemnities have also been granted to the Trustees of Lloyds Banking Group's Pension Schemes, including those schemes relevant to the Company, which were in force for the whole of the financial year and remain in force as at the date of this report.

Information required under DTR 7.2

Certain information is incorporated into this report by reference. Information about internal control and risk management systems relating to the financial reporting process can be found on page 6.

Information about share capital is shown in note 27 on page 73. The Company is a wholly owned subsidiary of Lloyds Bank plc, which holds all of the Company's issued ordinary share capital.

The directors manage the business of the Company under the powers set out in the Companies Act 2006 and the Company's articles of association, these powers include those in relation to the issue or buy back of the Company's shares.

The appointment and retirement of directors is governed by the Company's articles of association 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.

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 Chair 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 Board and a register of directors' interests is regularly reviewed and authorised by the Board to ensure the authorisation status remains appropriate.

Lord Lupton is a senior adviser 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 authorised the potential conflicts and requires Lord Lupton to recuse himself from discussions, should the need arise.

Future developments and financial risk management objectives and policies

Information regarding future developments and financial risk management objectives and policies of the Group in relation to the use of financial instruments that would otherwise be required to be disclosed in the directors' report, and which is incorporated into this report by reference, can be found in the strategic report.

Share capital

Information about share capital is shown in note 27 on page 73. This information is incorporated into this report by reference. The Company did not repurchase any of its shares during 2022 (2021: none). 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.

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.

Research and development activities

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

Supporting disability

As part of Lloyds Banking Group, the Company's aim is to create an inclusive and accessible working environment where everyone is supported to reach their full potential. Lloyds Banking Group continues to hold the Business Disability Forum Gold Standard accreditation and Disability Confident status from the Department for Work and Pensions, and offers bespoke training, career development and adjustments for colleagues and applicants with disabilities, including those who became disabled while employed.

Information incorporated by reference

The following additional information forms part of the directors' report, and is incorporated by reference.

Content		Pages
Disclosures required under the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008	Statement of employee engagement	2 to 4
	Statement of other stakeholder engagement	2 to 4

Significant contracts

Details of related party transactions are set out in note 33 on pages 78 to 79.

Streamlined Energy and Carbon Reporting

The Company has taken advantage of the exemption from Streamlined Energy and Carbon Reporting (SECR) reporting requirements in its own directors' report as it is covered by the Lloyds Banking Group SECR report given in the Lloyds Banking Group plc 2022 Annual Report and Accounts, available at www.lloydsbankinggroup.com/investors/financial-downloads.html

Statement of directors' responsibilities

The directors are responsible for preparing the Annual 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 are required to prepare the Company's and the Group's financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. 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 Company and the Group, and of the profit or loss of the Company and the Group for that period. In preparing these financial statements, the directors are required to properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; provide additional disclosures when compliance with the specific requirements in international accounting standards in conformity with the requirements of the Companies Act 2006 are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and make an assessment of the Company's ability to continue as a going concern.

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 comply with the Companies Act 2006. 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 the website www.lloydsbankinggroup.com/investors/financial-downloads.html. The directors are responsible for the maintenance and integrity of all information relating to the Company on that 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 page 11 of this annual report, confirm that, to the best of his or her knowledge:

- The Company's and the Group's financial statements, which have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the 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 Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's and the Group's position, performance, business model and strategy. The directors have also separately reviewed and approved the strategic report

Independent auditor and audit information

Each person who is a director at the date of approval of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

On behalf of the Board

Kate Cheetham

Kate Cheetham
Company Secretary
7 March 2023

HBOS plc
Registered in Scotland
Company Number SC218813

HBOS plc

Current directors

Executive directors:

Charlie Nunn *Group Chief Executive*

William Chalmers *Chief Financial Officer*

Non-executive directors:

Robin Budenberg CBE *Chair*

Alan Dickinson *Deputy Chair*

Sarah Legg

Lord Lupton CBE

Amanda Mackenzie LVO OBE

Harmeen Mehta

Cathy Turner

Scott Wheway

Catherine Woods

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 HBOS plc together with its subsidiaries (the Group) and its current goals and expectations. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. Words such as, without limitation, 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'deliver', 'endeavour', 'prospects', 'optimistic' and similar expressions or variations on these expressions are intended to identify forward looking statements. These statements concern or may affect future matters, including but 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; the Group's ESG targets and/or commitments; statements of plans, objectives or goals of the Group or its management and other statements that are not historical fact; expectations about the impact of COVID-19; 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 include, but are not limited to: general economic and business conditions in the UK and internationally; political instability including as a result of any UK general election and any further possible referendum on Scottish independence; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; the war between Russia and Ukraine; the tensions between China and Taiwan; market related risks, trends and developments; exposure to counterparty risk; instability in the global financial markets, including within the Eurozone, and as a result of the exit by the UK from the European Union (EU) and the effects of the EU-UK Trade and Cooperation Agreement; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; volatility in credit markets; volatility in the price of the Group's securities; tightening of monetary policy in jurisdictions in which the Group operates; natural pandemic (including but not limited to the COVID-19 pandemic) and other disasters; risks concerning borrower and counterparty credit quality; longevity risks affecting defined benefit pension schemes; risks related to the uncertainty surrounding the integrity and continued existence of reference rates; changes in laws, regulations, practices and accounting standards or taxation; changes to regulatory capital or liquidity requirements and similar contingencies; the policies and actions of governmental or regulatory authorities or courts together with any resulting impact on the future structure of the Group; risks associated with the Group's compliance with a wide range of laws and regulations; assessment related to resolution planning requirements; risks related to regulatory actions which may be taken in the event of a bank or Group failure; exposure to legal, regulatory or competition proceedings, investigations or complaints; failure to comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations; failure to prevent or detect any illegal or improper activities; operational risks; conduct risk; 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; technological failure; inadequate or failed internal or external processes or systems; risks relating to ESG matters, such as climate change (and achieving climate change ambitions), including the Group's ability along with the government and other stakeholders to measure, manage and mitigate the impacts of climate change effectively, and human rights issues; the impact of competitive conditions; failure to attract, retain and develop high calibre talent; the ability to achieve strategic objectives; the ability to derive cost savings and other benefits including, but without limitation, as a result of any acquisitions, disposals and other strategic transactions; inability to capture accurately the expected value from acquisitions; assumptions and estimates that form the basis of the Group's financial statements; and potential changes in dividend policy. A number of these influences and factors are beyond the control of the Group or any of the Group's immediate or ultimate parent entities (if applicable). Please refer to the latest Annual Report on Form 20-F filed by Lloyds Bank plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks. Lloyds Banking Group plc may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc 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 whether as a result of new information, future events or otherwise. 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HBOS PLC

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of HBOS plc (the 'Parent company') and its subsidiaries (the 'Group' or 'HBOS') give a true and fair view of the state of the Group's and of the Parent company's affairs as at 31 December 2022 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB);
- the Parent company financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise the:

Group	Parent company
• Consolidated balance sheet as at 31 December 2022; • Consolidated income statement for the year then ended; • Consolidated statement of comprehensive income for the year then ended; • Consolidated statement of changes in equity for the year then ended; • Consolidated cash flow statement for the year then ended; and • Notes 1 to 40 to the financial statements, which include the accounting principles and policies.	• Balance sheet as at 31 December 2022; • Statement of comprehensive income for the year then ended; • Statement of changes in equity for the year then ended; • Cash flow statement for the year then ended; and • Notes 1 to 40 to the financial statements, which include the accounting principles and policies, as applicable to the Parent company.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom adopted international accounting standards, and as regards to the Parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditors' responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and the Parent company for the year are disclosed in note 9 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the Group or the Parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Expected credit losses (Group) • Regulatory and litigation matters (Group) • Defined benefit obligations (Group and Parent company) • IT systems that impact financial reporting (Group and Parent company) Our assessment of the level of risk for each of these areas have remained consistent with the prior year.
Materiality	Overall materiality used for the Group consolidated financial statements was £125 million, which was determined on the basis of profit before tax and net assets. Overall materiality used for the Parent company financial statements was £125 million, which was determined on the basis of net assets and capped at Group materiality.
Scoping	Our audit scope covers 91% of the Group's revenue, 90% of the Group's profit before tax, 98% of the Group's total assets and 98% of the Group's total liabilities.

Our audit approach

Our audit approach is risk focused and structured to reflect the Group's organisation. It can be summarised into the following key activities that we used to obtain sufficient audit evidence required to form our opinion on the Group and the Parent company's financial statements:

- **Audit planning and risk assessment**

We considered the macroeconomic factors affecting the Group during the year and assessed the impact of the war in Ukraine, the current economic environment and changes to UK fiscal policy on the Group's key judgements and sources of estimation uncertainty. The partners and those leading areas requiring significant audit judgement including expected credit losses, provisions for regulatory and litigation matters and defined pension obligations were required to consider these factors in their assessment of risk and to design testing procedures to adequately address the assessed risk. These partners also met regularly with management to understand business strategy, the Group's accounting judgements and estimations as well as other matters which arose during the year, which could have impacted the Group's financial reporting. Our risk assessments were further informed by detailed analytics as well as other quantitative and qualitative audit procedures, including consideration of matters such as the impact of cost of living pressures in the UK and climate change on the account balances, disclosures and company practices;

- **Audit procedures undertaken at both Group and Parent company level**

In addition to the above, we also performed audit work on the Group and Parent company financial statements including the consolidation of the Group's results, the preparation of the financial statements, litigation provisions and exposures in addition to the Group's entity level and oversight controls relevant to financial reporting. The areas not covered by our audit scope are subject to analytical procedures to confirm our conclusion that there were no significant risks of material misstatement in the aggregated financial information;

- **Internal controls testing approach**

Our internal controls testing approach was informed by our scoping and risk assessment activities. We have assessed the Group's end-to-end financial reporting processes supporting all in-scope financial statement balances and identified relevant controls to test for these balances. This included the testing of general IT controls, process level controls and entity level controls at the Group level; and

- **The impact of climate change on our audit**

In planning our audit, we have considered the impact of climate change on the Group's operations and any subsequent impact on its financial statements. The Group sets out its assessment of the potential impact on pages 4 and 5 of the Strategic report of the Annual Report.

In conjunction with our climate risk specialists, we have held discussions with the Group to understand their:

– process for identifying affected operations including the governance and controls over this process, and the subsequent effect on financial reporting for the Group; and

– long-term strategy to respond to climate change risks and how this is factored into the Group's forecasts, considering publicly announced climate change commitments and any costs associated with the Group's net zero targets.

Our audit work has involved:

– evaluating climate as a factor in risk assessments for potentially affected balances;

– challenging the completeness of the physical and transition risks identified and considered in the Group's climate risk assessment and the conclusion that there continues to be no material impact of climate change risk on financial reporting;

– reviewing the Group's qualitative loan portfolio analysis, and challenging the key assumptions used by the Group with reference to our own understanding of the portfolios and publicly available documentation; and

– assessing disclosures in the Annual Report, and challenging the consistency between the financial statements and the remainder of the Annual Report.

As part of our audit procedures we are required to read and consider these disclosures to consider whether they are materially inconsistent with the financial statements or knowledge obtained in the audit and we did not identify any material inconsistencies as a result of these procedures.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the Group's and the Parent company's ability to continue to adopt the going concern basis of accounting included:

- using our knowledge of the Group and Parent company, the financial services industry, the financial services regulatory environment and the general economic environment including, macroeconomic pressures affecting the Group's operations, to identify inherent risks in the business model and how such risks might affect the financial resources or ability to continue operations over the going concern period;
- evaluating the Group's strategic plans in light of the changing macroeconomic environment, short and longer term financial budgets, funding, liquidity and capital adequacy plans including internal stress tests;
- considering the Group's operational resilience;
- reading analyst reports, industry data, Bank of England reports and other external information to determine if it provided corroborative or contradictory evidence in relation to the Group's assumptions;
- reviewing correspondence and meeting with prudential and conduct regulators to assess whether there are any matters that may impact the going concern assessment; and
- evaluating the Group's disclosures on going concern against the requirements of IAS 1.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's and the Parent company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our 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) that we identified. These matters included 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 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.

Expected credit losses (Group)

Key audit matter description	How the scope of our audit responded to the key audit matter
Refer to notes 2, 3, 10, 14 and 38 in the financial statements The Group has recognised £3.3 billion of expected credit losses ("ECL") as at 31 December 2022. The determination of ECL consists of a number of assumptions that require a high degree of complex and subjective auditor judgement, specialised skills and knowledge, complex impairment modelling and a high degree of estimation uncertainty. Specifically, the impact of the war in Ukraine, residual economic impact of the COVID-19 pandemic, as well as the economic impact of the rising cost of living on the ECL have been particularly judgemental given the inherent uncertainty in the current economic environment. The key areas we identified as having the most significant level of management judgement were in respect of: • Multiple Economic Scenarios ("MES"); • Retail ECL; and • Commercial Banking ECL.	
Multiple economic scenarios The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. The Group's economics team develops the future economic scenarios. Firstly, a base case forecast is produced based on a set of conditioning assumptions, which are designed to reflect the Group's best view of future events. A full distribution of economic scenarios around this base case is produced using a Monte Carlo simulation and scenarios within that distribution are ranked using estimated relationships with industry wide historical loss data. Three scenarios are derived from the distribution as averages of constituent modelled scenarios around the 15th, 75th and 95th percentiles of the distribution corresponding to an upside, a downside and a severe downside, respectively. The severe downside is then adjusted to incorporate non-modelled paths for inflation and interest rate assumptions. The upside, the base case and the downside scenarios are weighted at 30% and the severe downside at 10%. These four scenarios are then used as key assumptions in the determination of the ECL allowance. The development of these multiple economic scenarios is inherently uncertain, highly complex, and requires significant judgement. The principal consideration for our determination that the multiple economic scenarios is a critical audit matter was the high degree of management judgement which required specialised auditor knowledge and a high degree of audit effort in areas such as evaluating the forward-looking information used by management, and the weighting applied.	We performed the following procedures: • Tested the controls over the generation of the multiple economic scenarios including those over the Group's governance processes to determine the base case, different scenarios and the weightings applied to each scenario; • Working with our internal economic specialists: – challenged and evaluated economic forecasts in the base scenario such as the unemployment rate, House Price Index, inflation and forecasted interest rates, and Gross Domestic Product through comparison to independent economic outlooks, external analysts and market data; – challenged the appropriateness of management's change in methodology in determining the severe downside scenario; – challenged and evaluated the appropriateness of the methodology applied to generate alternative macroeconomic scenarios, and including associated weightings and assumptions within; – independently replicated the multiple economic scenario model and compared the outputs of our independent model to the Group's output to test scenario generation; • Tested the completeness and accuracy of the data used by the model; • Performed a stand back assessment of the appropriateness of the weightings applied to each of the scenarios based on publicly available data; and • Evaluated the adequacy of disclosures in respect of significant judgements and sources of estimation uncertainty including macroeconomic scenarios.

Key audit matter description	How the scope of our audit responded to the key audit matter
Retail ECL The ECL for Retail is determined on a collective basis using impairment models to calculate a probability weighted estimate by applying a probability of default, exposure at default and a loss given default, taking account of collateral held or other loss mitigants, discounted using the effective interest rate. The key judgements and estimates in determining the ECL for Retail include: • Modelling approach, modelling simplifications and judgements, and selection of modelling data; • Behavioural lives; and • The appropriate allocation of assets into the correct IFRS 9 stage through the assessment of significant deterioration in credit risk since origination. **Model adjustments** Adjustments are made to models to address known model and data limitations, and emerging or non-modelled risks. The current economic environment continues to be uncertain and differs from recent experience being characterised by elevated inflation, the "cost of living" crisis for personal borrowers, and higher finance costs, all of which affect the debt servicing capacity of borrowers. As a result, the judgements around if and when the Group have recognised adjustments in the model to account for the impacts of the current economic environment and potential model weaknesses in coping with the current economic outlook are highly judgmental and inherently uncertain. These adjustments require specialist auditor judgement when evaluating the completeness of adjustments, and the methodology, models and inputs to the adjustments.	We tested controls across the process to determine the ECL provisions including: • Model governance, including model validation and monitoring; • Model assumptions; • The allocation of assets into stages; and • Data accuracy and completeness. Working with our internal modelling specialists our audit procedures over the key areas of estimation covered the following: • Model estimations, where we: – evaluated the appropriateness of the modelling approach and assumptions used; – independently replicated the models for the most material portfolios and compared the outputs of our independent models to the Group's outputs; – assessed model performance by evaluating variations between observed data and model predictions; – developed an understanding and assessed model limitations and remedial actions; and – tested the completeness and accuracy of the data used in model execution and calibration. • Allocation of assets into stages, where we: – evaluated the appropriateness of quantitative and qualitative criteria used for allocation into IFRS 9 stages; – tested the appropriateness of the stage allocation for a sample of exposures; and – tested the data used by models in assigning IFRS 9 stages and evaluated the appropriateness of the model logic used. **Model adjustments** In respect of the adjustment to models, we performed the following procedures in conjunction with our specialists: • Tested the controls over the adjustments to the models; • Evaluated the methodology, approach and assumptions in developing the adjustments, and evaluated the Group's selection of approach; • Tested the completeness and accuracy of the data used; • Performed a recalculation of the adjustments; • Evaluated the completeness of adjustments based on our understanding of model and data limitations, including those related to cost of living pressures; and • Evaluated whether duplication exists between different model adjustments and between model adjustments and core models. We have assessed the adequacy of the disclosures and whether the disclosures appropriately address the uncertainty which exists in determining the ECL.

Key audit matter description	How the scope of our audit responded to the key audit matter
Commercial Banking ECL The ECL in Commercial Banking is calculated on a collective basis for performing loans, being those in stage 1 and 2, and on an individual basis for larger impaired loans in stage 3. The collective provision is determined using impairment models. The models use a number of significant judgments to calculate a probability weighted ECL estimate applying an appropriate probability of default, estimated exposure at default and taking account of collateral held or other loss mitigants, discounted using the effective interest rate. The key driver of the probability of default and, therefore, the staging of Commercial Banking exposures is the credit risk rating. The determination of these credit risk ratings is performed on a counterparty basis for larger exposures by a credit officer and involves a high degree of judgement and consideration of multiple sources of information. Complex models and significant judgements are used to develop the probability of default, loss given default and exposure at default as well as applying the staging criteria under IFRS 9. For individual provision assessments of larger exposures in stage 3, the significant judgements in determining provisions are the: • completeness and appropriateness of the potential workout scenarios identified; • probability assigned to each identified potential workout scenarios; and • valuation assumptions used in determining the expected recovery strategies. Complex and subjective auditor judgement including specialised knowledge is required in evaluating the methodology, models and inputs that are inherently uncertain.	We tested the controls across the process to determine the ECL provisions including: • Model governance and arithmetical accuracy of provision calculations; • Data accuracy and completeness; and • Recognition and calculation of post-model adjustments. We performed the following audit procedures over: • Expected credit losses determined through impairment models: – independently assessed the credit rating and tested whether the exposure was in the correct stage and whether a significant increase in credit risk had occurred to result in a stage 2 classification against IFRS 9 criteria; – assessed and challenged the model methodologies, approach and assumptions, including those used in developing the IMAs and PMAs; – tested the completeness and accuracy of data used; and – performed a recalculation of the IFRS 9 collective provision. • Expected credit losses assessed individually: – assessed the exposures to determine if they met the definition of credit impaired with a stage 3 classification; – performed independent assessments to determine the appropriateness of recovery scenarios and associated cash flows, including considerations of climate risks on recoveries; – evaluated valuations, including the use of internal specialists for business valuations; and – independently assessed and challenged the completeness of workout scenarios identified and weightings applied. We have assessed the adequacy of the disclosures and whether the disclosures appropriately address the uncertainty which exists in determining the ECL.

Key observations communicated to the Audit Committee

We are satisfied that the ECL provisions are reasonable and recognised in accordance with the requirements of IFRS 9. The calculations are based on appropriate methodologies using reasonable modelled assumptions, including IMAs and PMAs addressing model shortcomings. Where control deficiencies were identified, particularly in data linkage to models, compensating controls were identified and operated effectively. Overall, we are comfortable with the Group's conclusions in respect of ECL.

Regulatory and litigation matters (Group and Parent company)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
Refer to notes 2, 3 and 25 in the financial statements.	
The Group operates in an environment where it is subject to regulatory investigations, litigation and customer remediation, including allegations of fraud and misconduct. The Group is currently exposed to a number of regulatory and litigation matters. The Group's provision for these matters is £0.7 billion as at 31 December 2022, the most significant of which is the HBOS Reading matter. Significant judgement is required by the Group in determining whether, under IAS 37 Provisions, Contingent Liabilities and Contingent Assets: • Based on the information available to the Group, the amount recorded is representative of the Group's best estimate to settle the obligation; and • Any contingent liabilities and underlying significant estimation uncertainties are adequately disclosed.	We performed the following audit procedures: • Tested the Group's controls over the completeness of provisions, the review of the assessment of the provision against the requirements of IAS 37, the review of the appropriateness of judgements used to determined a 'best estimate' and the completeness and accuracy of data used in the process; • Evaluated the assessment of the provisions, associated probabilities, and potential outcomes in accordance with IAS 37; • Verified and challenged whether the methodology, data and significant judgements and assumptions used in the valuation of the provisions are appropriate in the context of the applicable financial reporting framework; • In respect of HBOS Reading, we inspected information available including outcomes for the awards made by the Foskett panel and tested the methodology applied to determine the provision; • Inspected correspondence and, where appropriate, made direct inquiry with the Group's regulators and internal and external legal counsel; • Where no provision was made, we critically assessed and challenged the conclusion in the context of the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets; and • Evaluated whether the disclosures made in the financial statements appropriately reflect the facts and key sources of estimation uncertainty.
Key observations communicated to the Audit Committee While there is significant judgement required in estimating the timing and value of future settlements, particularly in relation to the HBOS Reading matter, we are satisfied that the approach to the estimation of these provisions is consistent with the requirements of IAS 37.	

Defined benefit obligations (Group and Parent company)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
Refer to notes 2, 3 and 23 in the financial statements	
The Group operates a number of defined benefit retirement schemes, the obligations for which totalled £9.7 billion as at 31 December 2022. Their valuation is determined with reference to key actuarial assumptions including mortality assumptions, discount rates and inflation rates. Due to the size of these schemes, small changes in these assumptions can have a material impact on the value of the defined benefit obligation and therefore, the assessment of these assumptions are a key judgement.	We performed the following audit procedures: • Tested the Group's controls over the valuation of the defined benefit obligations, including controls over the assumptions setting process; and • Challenged the key actuarial assumptions used by comparing these against ranges and expectations determined by our internal actuarial experts, which are calculated with reference to the central assumptions adopted by the actuarial firms for whom we have reviewed and accepted their methodologies.
Key observations communicated to the Audit Committee We are satisfied that the Group's judgements in relation to the actuarial assumptions are reasonable.	

IT systems that impact financial reporting (Group and Parent company)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
The Group's IT environment is inherently complex due to the number of systems it operates and its reliance on automated and IT dependent manual controls. Together, these support a broad range of banking and insurance products as well as the processing of the Group's significant volume of transactions, which impact all account balances. As such, IT systems within the Group form a critical component of the Group's financial reporting activities. Due to the significant reliance on IT systems, effective General IT Controls (GITCs) are critical to allow reliance to be placed on the completeness and accuracy of financial data and the integrity of automated system functionality, such as system calculations. We identified the IT systems that impact financial reporting as a key audit matter because of the: • Pervasive reliance on complex technology that is integral to the operation of key business processes and financial reporting; • Reliance on technology which continues to develop in line with the business strategy, such as the increase in the use of automation across the Group and increasing reliance on third parties; and • Importance of the IT controls in maintaining an effective control environment. A key interdependency exists between the ability to rely on IT controls and the ability to rely on financial data, system configured automated controls and system reports. IT controls, in the context of our audit scope, primarily relate to privileged access at the infrastructure level, user access security at the application level and change control.	Our IT audit scope tested the Group's IT controls over information systems deemed relevant to the audit based on the financial data, system configured automated controls and/or key financial reports that reside within it. We used IT specialists to support our evaluation of the risks associated with IT in the following areas: • General IT Controls, including user access and change management controls; • Key financial reports and system configured automated controls; and • Cyber security risk assessment. Where deficiencies in the IT control environment were identified, our risk assessment procedures included an assessment of those deficiencies to determine the impact on our audit plan. Where relevant, the audit plan was adjusted to mitigate the unaddressed IT risk. Where we were able to identify and test appropriate mitigating controls over affected financial statement line items, our testing approach remained unchanged. In a limited number of areas, we adopted a non-controls reliance approach and we therefore performed additional substantive procedures.

Key observations communicated to the Audit Committee

IT control deficiencies were identified in respect of privileged user access to IT infrastructure and in application user access management. The existence of these deficiencies in the year resulted in an increased risk in relation to data, reports and automated system functionality from the affected systems.

However, overall, in combination with business mitigating controls, we are satisfied that the Group's overall IT control environment appropriately supports the financial reporting process.

6. Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£125 million (2021: £155 million)	£125 million (2021: £155 million)
Basis for determining materiality	In determining our benchmark for materiality, we have considered the metrics used by investors and other users of the financial statements. We have determined the following benchmarks to be the most relevant to users of the financial statements: • Net assets; and • Pre-tax profit. The determined materiality represents 10% of pre-tax profit and 0.7% of net assets.	The Parent company materiality represents 0.5% of net assets, and is capped at Group materiality.
Rationale for the benchmark applied	Given the importance of these measures to investors and users of the financial statements, we have used net assets as the primary benchmark and forecasted pre-tax profit as a supporting benchmark for our determination of materiality given the volatility of income statement items during the course of 2022.	As the Parent company does not disclose a standalone income statement we do not consider an income based metric to be an appropriate benchmark for the purposes of setting materiality when considering the expectations of the user of the Parent company financial statements. As such we have determined that a net assets benchmark is appropriate. We have capped materiality at Group's materiality.

6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Parent company financial statements
Performance materiality	70% of Group materiality – £80 million (2021: 60% at £92 million)	70% of Parent company materiality – £80 million (2021: 60% at £92 million)
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: a. The quality of the control environment and whether we were able to rely on controls; b. Degree of centralisation and commonality of controls and processes; c. The uncertain economic environment; d. The nature, volume and size of uncorrected misstatements arising in the previous audit; and e. The nature, volume and size of uncorrected misstatements that remain uncorrected in the current period. In the prior year, performance materiality was set at 60% reflecting amongst other factors that it was Deloitte LLP's first year auditing the Group and Parent financial statements.	

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £5 million (2021: £8 million), as well as any differences below this threshold, which in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. Other information

The other information comprises the information included in the Annual Report, other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information contained within the Annual Report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. 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 course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. 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 in this regard.**

We summarise below our work in relation to areas of the other information including those areas upon which we are specifically required to report:

	Our responsibility	Our report
Matters we are specifically required to report		
Strategic report and directors' report	Report whether they are consistent with the audited financial statements and are prepared in accordance with applicable legal requirements. Report if we have identified any material misstatements in either report in the light of the knowledge and understanding of the Group and of the Parent company and their environment obtained in the course of the audit.	As set out in the section "Opinions on other matters prescribed by the Companies Act 2006", in our opinion, based on the work undertaken in the course of the audit, the information in these reports is consistent with the audited financial statements and has been prepared in accordance with applicable legal requirements.
Principal risks (within the strategic report)	Review the confirmation and description in the light of the knowledge gathered during the audit, such as through considering the directors' processes to support the statements made, challenging the Group's key judgements and estimates, consideration of historical forecasting accuracy and evaluating macro-economic assumptions.	We have nothing material to report, add or draw attention to in respect of these matters.

8. Responsibilities of Directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors 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.

9. 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.

10. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

Identifying and assessing potential risks related to irregularities

In identifying and assessing the risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- the Group's own assessment of the risks that irregularities may occur either as a result of fraud or error that was discussed by the Audit Committee on 20 February 2023;
- enquiring of management, in-house legal counsel, internal audit and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team including relevant internal specialists, including tax, valuations, pensions, IT and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud; and
- obtaining an understanding of the legal and regulatory frameworks that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements, such as provisions of the UK Companies Act, pensions legislation and tax legislation or that had a fundamental effect on the operations of the Group, including regulation and supervisory requirements of the Prudential Regulation Authority, Financial Reporting Council and Financial Conduct Authority.

Audit response to risks identified

As a result of performing the above, we identified the Group's determination of "Expected credit losses" as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures in response to those key audit matters. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- inquiring of management, the Audit Committee and in-house and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and correspondence with regulators; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

11. Opinions on other matters prescribed by the Companies Act 2006

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

- The information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- The strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and of the Parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

12. Matters on which we are required to report by exception

Adequacy of explanations received and accounting records Under the Companies Act 2006 we are required to report to you if, in our opinion: • We have not received all the information and explanations we require for our audit; or • Adequate accounting records have not been kept by the Parent company, or returns adequate for our audit have not been received from branches not visited by us; or • The Parent company's financial statements are not in agreement with the accounting records and returns.	**We have nothing to report in respect of these matters.**
Directors' remuneration Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.	**We have nothing to report in respect of this matter.**

13. Other matters which we are required to address

Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by shareholders at its annual general meeting on 12 May 2022 to audit the financial statements of Lloyds Banking Group plc, including HBOS plc for the year ended 31 December 2022 and subsequent financial periods. The period of total uninterrupted engagement of the firm is accordingly two years.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

14. Use of our report

This report is made solely to the Parent company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Parent company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Parent company and the Parent company's members as a body, for our audit work, for this report, or for the opinions we have formed.

As required by the Financial Conduct Authority (FCA) Disclosure Guidance and Transparency Rule (DTR) 4.1.14R, these financial statements form part of the European Single Electronic Format ('ESEF') prepared Annual Financial Report filed on the National Storage Mechanism of the UK FCA in accordance with the ESEF Regulatory Technical Standard ('ESEF RTS'). This auditors' report provides no assurance over whether the annual financial report has been prepared using the single electronic format specified in the ESEF RTS.

Michael Lloyd

Michael Lloyd (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

7 March 2023

Consolidated income statement

for the year ended 31 December 2022

	Note	**2022 £ million**	2021 £ million
Interest income		**8,155**	7,167
Interest expense		**(3,574)**	(1,781)
Net interest income	4	**4,581**	5,386
Fee and commission income		**615**	563
Fee and commission expense		**(315)**	(282)
Net fee and commission income	5	**300**	281
Net trading income	6	**59**	56
Other operating income	7	**52**	24
Other income		**411**	361
Total income		**4,992**	5,747
Operating expenses	8	**(3,153)**	(3,850)
Impairment (charge) credit	10	**(630)**	374
Profit before tax		**1,209**	2,271
Tax expense	11	**(69)**	(427)
Profit for the year		**1,140**	1,844
Profit attributable to ordinary shareholders		**1,018**	1,734
Profit attributable to non-controlling interests		**122**	110
Profit for the year		**1,140**	1,844

The accompanying notes are an integral part of the consolidated financial statements.

Statements of comprehensive income

for the year ended 31 December 2022

	The Group		The Company	
	2022 £ million	2021 £ million	**2022 £ million**	2021 £ million
Profit for the year	**1,140**	1,844	**32**	1,224
Other comprehensive income				
Items that will not subsequently be reclassified to profit or loss:				
Post-retirement defined benefit scheme remeasurements:				
Remeasurements before tax	**(1,031)**	686	**(1,019)**	698
Tax	**211**	(226)	**204**	(226)
	(820)	460	**(815)**	472
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	**(73)**	(2)	**–**	–
Income statement transfers in respect of disposals	**15**	–	**–**	–
Tax	**14**	12	**–**	–
	(44)	10	**–**	–
Movements in cash flow hedging reserve:				
Effective portion of changes in fair value taken to other comprehensive income	**11**	(48)	**–**	–
Net income statement transfers	**(11)**	19	**–**	–
Tax	**(2)**	11	**–**	–
	(2)	(18)	**–**	–
Movements in foreign currency translation reserve:				
Currency translation differences (tax: £nil)	**–**	1	**–**	–
Total other comprehensive (loss) income for the year, net of tax	**(866)**	453	**(815)**	472
Total comprehensive income for the year	**274**	2,297	**(783)**	1,696
Total comprehensive income attributable to ordinary shareholders	**152**	2,187	**(783)**	1,696
Total comprehensive income attributable to non-controlling interests	**122**	110	**–**	–
Total comprehensive income for the year	**274**	2,297	**(783)**	1,696

The accompanying notes are an integral part of the consolidated financial statements.

HBOS plc

Balance sheets

at 31 December 2022

	Note	The Group 2022 £ million	The Group 2021 £ million	The Company 2022 £ million	The Company 2021 £ million
Assets					
Cash and balances at central banks		**3,004**	3,201	**–**	–
Items in the course of collection from banks		**47**	47	**–**	–
Financial assets at fair value through profit or loss		**291**	362	**–**	384
Derivative financial instruments	12	**3,477**	4,184	**27**	163
Loans and advances to banks		**271**	102	**–**	–
Loans and advances to customers		**292,416**	279,409	**–**	–
Due from fellow Lloyds Banking Group undertakings		**13,982**	15,181	**3,209**	2,655
Financial assets at amortised cost	13	**306,669**	294,692	**3,209**	2,655
Financial assets at fair value through other comprehensive income		**103**	2,179	**–**	–
Goodwill	16	**452**	325	**–**	–
Current tax recoverable		**542**	317	**152**	84
Deferred tax assets	24	**1,501**	1,502	**–**	–
Investment in subsidiary undertakings	17	**–**	–	**22,634**	22,588
Retirement benefit assets	23	**1,513**	1,749	**1,466**	1,691
Other assets	18	**1,968**	1,561	**–**	1
Total assets		**319,567**	310,119	**27,488**	27,566
Liabilities					
Deposits from banks		**195**	597	**–**	–
Customer deposits		**166,363**	170,777	**–**	–
Repurchase agreements		**30,210**	30,028	**–**	–
Due to fellow Lloyds Banking Group undertakings		**88,180**	74,789	**2,502**	1,879
Items in the course of transmission to banks		**118**	98	**–**	–
Financial liabilities at fair value through profit or loss		**26**	33	**–**	–
Derivative financial instruments	12	**4,544**	4,157	**–**	80
Notes in circulation		**1,280**	1,321	**–**	–
Debt securities in issue	20	**6,123**	7,353	**–**	–
Other liabilities	22	**1,601**	1,629	**3**	3
Retirement benefit obligations	23	**76**	129	**76**	129
Deferred tax liabilities	24	**–**	–	**348**	390
Other provisions	25	**973**	1,057	**–**	–
Subordinated liabilities	26	**2,456**	2,562	**819**	1,208
Total liabilities		**302,145**	294,530	**3,748**	3,689
Equity					
Share capital	27	**3,778**	3,763	**3,778**	3,763
Share premium account	28	**585**	–	**585**	–
Other reserves	29	**11,173**	10,165	**9,678**	9,678
Retained profits[1]	30	**(337)**	(562)	**9,699**	10,436
Ordinary shareholders' equity		**15,199**	13,366	**23,740**	23,877
Non-controlling interests		**2,223**	2,223	**–**	–
Total equity		**17,422**	15,589	**23,740**	23,877
Total equity and liabilities		**319,567**	310,119	**27,488**	27,566

1 The Company recorded a profit after tax for the year of £32 million (2021: £1,224 million).

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the financial statements on 7 March 2023.

Robin Budenberg
Chair

Charlie Nunn
Chief Executive

William Chalmers
Chief Financial Officer

Statements of changes in equity

for the year ended 31 December 2022

	Attributable to ordinary shareholders					
The Group	**Share capital and premium £ million**	**Other reserves £ million**	**Retained profits £ million**	**Total £ million**	**Non-controlling interests £ million**	**Total £ million**
At 1 January 2021	3,763	10,172	(2,292)	11,643	2,223	13,866
Comprehensive income						
Profit for the year	–	–	1,734	1,734	110	1,844
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	460	460	–	460
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	–	10	–	10	–	10
Movements in cash flow hedging reserve, net of tax	–	(18)	–	(18)	–	(18)
Movements in foreign currency translation reserve, net of tax	–	1	–	1	–	1
Total other comprehensive (loss) income	–	(7)	460	453	–	453
Total comprehensive (loss) income[1]	–	(7)	2,194	2,187	110	2,297
Transactions with owners						
Dividends (note 31)	–	–	(500)	(500)	(1)	(501)
Distributions to non-controlling interests	–	–	–	–	(109)	(109)
Capital contributions received	–	–	36	36	–	36
Total transactions with owners	–	–	(464)	(464)	(110)	(574)
At 31 December 2021	3,763	10,165	(562)	13,366	2,223	15,589
Comprehensive income						
Profit for the year	**–**	**–**	**1,018**	**1,018**	**122**	**1,140**
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**(820)**	**(820)**	**–**	**(820)**
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	**–**	**(44)**	**–**	**(44)**	**–**	**(44)**
Movements in cash flow hedging reserve, net of tax	**–**	**(2)**	**–**	**(2)**	**–**	**(2)**
Total other comprehensive loss	**–**	**(46)**	**(820)**	**(866)**	**–**	**(866)**
Total comprehensive (loss) income[1]	**–**	**(46)**	**198**	**152**	**122**	**274**
Transactions with owners						
Distributions to non-controlling interests	**–**	**–**	**–**	**–**	**(122)**	**(122)**
Issue of ordinary shares	**600**	**–**	**–**	**600**	**–**	**600**
Capital contributions received	**–**	**1,054**	**46**	**1,100**	**–**	**1,100**
Adjustment on transfer of subsidiary	**–**	**–**	**(19)**	**(19)**	**–**	**(19)**
Total transactions with owners	**600**	**1,054**	**27**	**1,681**	**(122)**	**1,559**
At 31 December 2022	**4,363**	**11,173**	**(337)**	**15,199**	**2,223**	**17,422**

1 Total comprehensive income attributable to owners of the parent was £152 million (2021: £2,187 million).

Further details of movements in the Group's share capital and reserves are provided in notes 27, 28, 29 and 30.

The accompanying notes are an integral part of the consolidated financial statements.

Statements of changes in equity

for the year ended 31 December 2022

	Attributable to ordinary shareholders			
The Company	**Share capital and premium £ million**	**Other reserves £ million**	**Retained profits £ million**	**Total £ million**
At 1 January 2021	3,763	9,678	9,204	22,645
Comprehensive income				
Profit for the year	–	–	1,224	1,224
Other comprehensive income				
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	472	472
Total comprehensive income[1]	–	–	1,696	1,696
Transactions with owners				
Dividends (note 31)	–	–	(500)	(500)
Capital contributions received	–	–	36	36
Total transactions with owners	–	–	(464)	(464)
At 31 December 2021	3,763	9,678	10,436	23,877
Comprehensive income				
Profit for the year	**–**	**–**	**32**	**32**
Other comprehensive income				
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**(815)**	**(815)**
Total comprehensive income[1]	**–**	**–**	**(783)**	**(783)**
Transactions with owners				
Dividends (note 31)	**–**	**–**	**–**	**–**
Issue of ordinary shares	**600**	**–**	**–**	**600**
Capital contributions received	**–**	**–**	**46**	**46**
Total transactions with owners	**600**	**–**	**46**	**646**
At 31 December 2022	**4,363**	**9,678**	**9,699**	**23,740**

1 Total comprehensive income attributable to owners of the parent was a deficit of £783 million (2021: surplus of £1,696 million).

Further details of movements in the Company's share capital and reserves are provided in notes 27, 28, 29 and 30.

The accompanying notes are an integral part of the consolidated financial statements.

Cash flow statements

for the year ended 31 December 2022

	Note	The Group 2022 £ million	The Group 2021[1] £ million	The Company 2022 £ million	The Company 2021 £ million
Profit before tax		**1,209**	2,271	**42**	1,255
Adjustments for:					
Change in operating assets	39(A)	**(5,727)**	(7,266)	**522**	5,315
Change in operating liabilities	39(B)	**2,503**	6,288	**543**	(6,568)
Non-cash and other items	39(C)	**(7)**	(128)	**(1,177)**	(1,509)
Tax paid (net)		**(238)**	(475)	**84**	51
Net cash (used in) provided by operating activities		**(2,260)**	690	**14**	(1,456)
Cash flows from investing activities					
Purchase of financial assets		**(564)**	(109)	**–**	–
Proceeds from sale and maturity of financial assets		**2,567**	399	**–**	–
Dividends received from subsidiaries		**–**	–	**–**	1,200
Purchase of fixed assets		**(158)**	(171)	**–**	–
Proceeds from sale of fixed assets		**–**	41	**–**	–
Net cash provided by investing activities		**1,845**	160	**–**	1,200
Cash flows from financing activities					
Dividends paid to ordinary shareholders	31	**–**	(500)	**–**	(500)
Dividends paid to non-controlling interests		**–**	(1)	**–**	–
Distributions to non-controlling interests		**(122)**	(109)	**–**	–
Interest paid on subordinated liabilities		**(101)**	(84)	**(43)**	(69)
Proceeds from issue of subordinated liabilities		**–**	500	**–**	–
Proceeds from issue of ordinary shares		**600**	–	**600**	–
Repayment of subordinated liabilities		**(60)**	(696)	**(16)**	(316)
Net cash used in financing activities		**317**	(890)	**541**	(885)
Effect of exchange rate changes on cash and cash equivalents		**–**	(1)	**–**	–
Change in cash and cash equivalents		**(98)**	(41)	**555**	(1,141)
Cash and cash equivalents at beginning of year		**2,185**	2,226	**2,580**	3,721
Cash and cash equivalents at end of year	39(D)	**2,087**	2,185	**3,135**	2,580

1 Restated, see page 30.

The accompanying notes are an integral part of the consolidated financial statements.

Notes to the accounts

Note 1: Basis of preparation

The consolidated financial statements of HBOS plc (the Company) together with its subsidiary undertakings (the Group) have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. The financial statements have also been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (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. The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements. In reaching this assessment, the directors have considered the impact of climate change upon the Group's performance and projected funding and capital position. The directors have also taken into account the results from stress testing scenarios.

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2023 (including IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). These amendments are not expected to have a significant impact on the Group.

In April 2022, the IFRS Interpretations Committee was asked to consider whether an entity includes a demand deposit as a component of cash and cash equivalents in the statement of cash flows when the demand deposit is subject to contractual restrictions on use agreed with a third party. It concluded that such amounts should be included within cash and cash equivalents. Accordingly, the Group includes mandatory reserve deposits with central banks that are held in demand accounts within cash and cash equivalents disclosed in the cash flow statement. This change has increased the Group's cash and cash equivalents at 1 January 2021 by £1,361 million (to £2,226 million); and increased the adjustment for the change in operating assets in 2021 by £50 million (to a reduction of £7,266 million) and, as a result, the Group's cash and cash equivalents at 31 December 2021 increased by £1,311 million (to £2,185 million). The change had no impact on profit after tax or total equity.

In 2021, the Group adopted the *Interest Rate Benchmark Reform* Phase 2 amendments issued by the IASB. These amendments require that changes to expected future cash flows that both arise as a direct result of IBOR Reform and are economically equivalent to the previous cash flows are accounted for as a change to the effective interest rate with no adjustment to the asset's or liability's carrying value; no immediate gain or loss is recognised. The requirements also provide relief from the requirements to discontinue hedge accounting as a result of amending hedge documentation if the changes are required solely as a result of IBOR Reform.

IFRS 8 *Operating Segments* requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. The chief operating decision-maker has been identified as the Group Executive Committee of Lloyds Banking Group. The HBOS Group is managed on an entity basis and not by segment. The Group Executive Committee does not assess the HBOS Group's performance and allocate resources across any segments, accordingly no segmental information is provided. A brief overview of the Group's sources of income is provided in the Business review. The ultimate parent undertaking, Lloyds Banking Group plc, produces consolidated accounts which set out the basis of the segments through which it manages performance and allocates resources across the consolidated Lloyds Banking Group.

Note 2: Accounting policies

The 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 page 105.

(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 have been 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.

Structured entities are entities that are designed so that their activities are not governed by way of voting rights. In assessing whether the Group has power over such entities in which it has an interest, the Group considers factors such as the purpose and design of the entity; its practical ability to direct the relevant activities of the entity; the nature of the relationship with the entity; and the size of its exposure to the variability of returns of the entity.

The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the Group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The acquisition method of accounting is used to account for business combinations by the Group. The consideration for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred except those relating to the issuance of debt instruments (see (E)(4) below) or share capital (see (O) below). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

Note 2: Accounting policies (continued)

(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 on initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for using 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. For impairment testing, goodwill is allocated to the cash generating unit (CGU) or groups of CGUs that are expected to benefit from the business combination. An impairment loss is recognised if the carrying amount of a CGU is determined to be greater than its recoverable amount. The recoverable amount of a CGU is the higher of its fair value less costs to sell and its value in use. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and this 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 intangible assets.

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.

(D) Revenue recognition

(1) Net interest income

Interest income and expense are recognised in the income statement using the effective interest method for all interest-bearing financial instruments, 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, other fees, and premiums and discounts that are an integral part of the overall return. In the case of financial assets that are purchased or originated credit-impaired, the effective interest rate is the rate that discounts the estimated future cash flows to the amortised cost of the instrument. 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 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 the lending expected to be drawn. Incremental costs incurred to generate fee and commission income are charged to fee and commission 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; and 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 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.

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.

Note 2: Accounting policies (continued)

(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, reverse repurchase agreements and certain debt securities used by the Group to manage its liquidity. Loans and advances and reverse repurchase agreements 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.

Where changes are made to the contractual cash flows of a financial asset or financial liability that are economically equivalent and arise as a direct consequence of interest rate benchmark reform, the Group updates the effective interest rate and does not recognise an immediate gain or loss.

(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, and this 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, other than those in effective cash flow and net investment hedging relationships. 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 35(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

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 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.

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.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices, respectively, which include the expected effects of potential changes to laws and regulations, risks associated with climate change and other factors. 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, repurchase agreements, 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 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 instrument is recognised in profit or loss.

Note 2: Accounting policies (continued)

(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 for repos carried at fair value are included within 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 measured at amortised cost or at fair value. Those measured at fair value are recognised within 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.

(F) Hedge accounting

As permitted by IFRS 9, the Group continues to apply the requirements of IAS 39 to its hedging relationships.

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) below, the change in fair value of a derivative in an effective cash flow hedging relationship is allocated between the income statement and other comprehensive income.

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 12 provides details of the types of derivatives held by the Group and presents separately those designated in hedge relationships.

Where there is uncertainty arising from 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.

Where the contractual terms of a financial asset, financial liability or derivative are amended, on an economically equivalent basis, as a direct consequence of interest rate benchmark reform, the uncertainty arising from the reform is no longer present. In these circumstances, the Group amends the hedge documentation to reflect the changes required by the reform; these changes to the documentation do not in and of themselves result in the discontinuation of hedge accounting or require the designation of a new hedge relationship.

(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.

(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 offset 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 reflects the change in expected credit losses, including those arising from fraud. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets (other than equity investments) 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 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. The collective assessment of impairment aggregates financial instruments with similar risk characteristics, such as whether the facility is revolving in nature or secured and the type of security against financial assets.

Note 2: Accounting policies (continued)

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. 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. The use of internal credit ratings and qualitative indicators ensures alignment between the assessment of staging and the Group's management of credit risk which utilises these internal metrics within distinct retail and commercial portfolio risk management practices. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. The use of a payment holiday in and of itself has not been judged to indicate a significant increase in credit risk, with the underlying long-term credit risk deemed to be driven by economic conditions and captured through the use of forward-looking models. These portfolio-level models are capturing the anticipated volume of increased defaults and therefore an appropriate assessment of staging and expected credit loss. 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 which the Group now uses for all its products following changes to the definition of default for UK Mortgages on 1 January 2022. In addition, other indicators of mortgage default are added including end-of-term payments on past due interest-only accounts and loans considered non-performing due to recent arrears or forbearance. The use of payment holidays is not considered to be an automatic trigger of regulatory default and therefore does not automatically trigger Stage 3. Days past due will also not accumulate on any accounts that have taken a payment holiday including those already past due.

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). On renegotiation the gross carrying amount of the loan is recalculated as the present value of the renegotiated or modified contractual cash flows, which are discounted at the original effective interest rate. Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value.

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, if appropriate, revised 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 assessing the recoverable amount of assets the Group considers the effects of potential or actual changes in legislation, customer behaviour, climate-related risks and other factors on the asset's CGU. In the event that an asset's CGU carrying amount is determined to be greater than its recoverable amount the asset is written down immediately.

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital accretion or both. 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 of 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 and residual value impairment, 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 lease. Unguaranteed residual values are reviewed regularly to identify any impairment.

Operating lease assets are included within other assets at cost and depreciated over their estimated useful lives. The depreciation charge is based on the asset's residual value and the life of the lease. 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.

Note 2: Accounting policies (continued)

(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, and the liability recognised within other liabilities.

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.

(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 pensionable service and pensionable 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.

(i) Defined benefit schemes

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 (i) its current right to obtain a refund or a reduction in future contributions and (ii) the rights of other parties existing at the balance sheet date. In determining the rights of third parties existing at the balance sheet date, the Group does not anticipate any future acts by other parties.

(ii) Defined contribution schemes

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

Lloyds Banking 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 His 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 remeasured as required to reflect current information.

Note 2: Accounting policies (continued)

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) 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. On disposal or liquidation of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation is reclassified from equity and included in determining the profit or loss arising on disposal or liquidation.

(N) 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).

(O) 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.

(P) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory deposits held with central banks, mandatory deposits held with central banks in demand accounts and amounts due from banks with an original maturity of less than three months that are available to finance the Group's day-to-day operations.

(Q) Investment in subsidiaries

Investments in subsidiaries are carried at historical cost, less any provisions for impairment.

Note 3: Critical accounting judgements and key sources of estimation uncertainty

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. In preparing the financial statements, the Group has considered the impact of climate-related risks on its financial position and performance. While the effects of climate change represent a source of uncertainty, the Group does not consider there to be a material impact on its judgements and estimates from the physical, transition and other climate-related risks in the short term.

The significant judgements, apart from those involving estimation, made by management in applying the Group's accounting policies in these financial statements (critical judgements) and the key sources of estimation uncertainty that may have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year (key sources of estimation uncertainty), which together are considered critical to the Group's results and financial position, are as follows:

Allowance for expected credit losses

Critical judgements:	Determining an appropriate definition of default against which a probability of default, exposure at default and loss given default parameter can be evaluated
	Establishing the criteria for a significant increase in credit risk (SICR)
	The use of management judgement alongside impairment modelling processes to adjust inputs, parameters and outputs to reflect risks not captured by models
Key source of estimation uncertainty:	Base case and multiple economic scenarios (MES) assumptions, including the rate of unemployment and the rate of change of house prices, required for creation of MES scenarios and forward-looking credit parameters

The Group recognises an allowance for expected credit losses (ECLs) for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets (other than equity investments) measured at fair value through other comprehensive income and certain loan commitment and financial guarantee contracts. At 31 December 2022, the Group's expected credit loss allowance was £3,324 million (2021: £2,638 million), of which £3,209 million (2021: £2,582 million) was in respect of drawn balances.

The calculation of the Group's expected credit loss allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Group to make a number of judgements, assumptions and estimates. Further information on the critical accounting judgements and key sources of estimation uncertainty (see above) and other significant judgements and estimates is set out in note 14.

Defined benefit pension scheme obligations

Critical judgement:	Determination of an appropriate yield curve
Key sources of estimation uncertainty:	Discount rate applied to future cash flows
	Expected lifetime of the schemes' members
	Expected rate of future inflationary increases

The net asset recognised in the balance sheet at 31 December 2022 in respect of the Group's defined benefit pension scheme obligations was £1,451 million comprising an asset of £1,513 million and a liability of £62 million (2021: a net asset of £1,658 million comprising an asset of £1,749 million and a liability of £91 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 sources of estimation uncertainty are the discount rate applied to future cash flows, the expected lifetime of the schemes' members and the expected rate of future inflationary increases.

Income statement and balance sheet sensitivities to changes in the critical accounting estimates and other actuarial assumptions are provided in part (v) of note 23.

Uncertain tax positions

Critical judgement:	Interpreting tax rules on the Group's open tax matters

The Lloyds Banking 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 Lloyds Banking Group that its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded their enquiry into the matter and issued a closure notice. The Lloyds Banking Group's interpretation of the UK rules has not changed and hence it has appealed to the First Tier Tax Tribunal, with a hearing expected in 2023. If the final determination of the matter by the judicial process is that HMRC's position is correct, management estimate that this would result in an increase in current tax liabilities of the Group of approximately £385 million (including interest). The Lloyds Banking Group, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

The Group makes other estimates in relation to tax which do not require significant judgements, see further discussion in note 24.

Note 3: Critical accounting judgements and key sources of estimation uncertainty (continued)

Regulatory and legal provisions

Critical judgements:	Determining the scope of reviews required by regulators
	The impact of legal decisions that may be relevant to claims received
	Determining whether a reliable estimate is available for obligations arising from past events
Key sources of estimation uncertainty:	The number of future complaints
	The proportion of complaints that will be upheld
	The average cost of redress

At 31 December 2022, the Group carried provisions of £709 million (2021: £835 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 estimation. 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 decisions reached by legal and other review processes 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.

Management has applied significant judgement in determining the provision required for HBOS Reading; further details are provided in note 25.

Fair value of financial instruments

Key source of estimation uncertainty:	Interest rate spreads, earnings multiples and interest rate volatility

At 31 December 2022, the carrying value of the Group's financial instrument assets held at fair value was £3,871 million (2021: £6,725 million), and its financial instrument liabilities held at fair value was £4,570 million (2021: £4,190 million).

The Group's valuation control framework and a description of level 1, 2 and 3 financial assets and liabilities is set out in note 35(2). The valuation techniques for 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 35.

Note 4: Net interest income

	Weighted average effective interest rate			
	2022 %	2021 %	**2022 £m**	2021 £m
Interest income:				
Financial assets held at amortised cost	**2.65**	2.43	**8,131**	7,146
Financial assets at fair value through other comprehensive income	**1.97**	0.91	**24**	21
Total interest income[1]	**2.65**	2.42	**8,155**	7,167
Interest expense:				
Deposits from banks and customer deposits	**1.38**	0.74	**(2,875)**	(1,616)
Repurchase agreements	**1.46**	0.11	**(440)**	(15)
Debt securities in issue[2]	**2.15**	0.44	**(146)**	(30)
Lease liabilities	**2.23**	2.29	**(13)**	(15)
Subordinated liabilities	**4.04**	4.04	**(100)**	(105)
Total interest expense	**1.44**	0.74	**(3,574)**	(1,781)
Net interest income			**4,581**	5,386

1 Includes £14 million (2021: £12 million) in respect of interest income on finance leases and £14 million (2021: £11 million) in respect of hire purchase receivables.

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 3.08 per cent (2021: 2.69 per cent).

Included within interest income is £190 million (2021: £119 million) in respect of credit-impaired financial assets. Net interest income also includes a credit of £11 million (2021: debit of £19 million) transferred from the cash flow hedging reserve (see note 29).

Note 5: Net fee and commission income

	2022 £m	2021 £m
Fee and commission income:		
Current accounts	**199**	196
Credit and debit card fees	**341**	245
Other	**75**	122
Total fee and commission income	**615**	563
Fee and commission expense	**(315)**	(282)
Net fee and commission income	**300**	281

Fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 4. 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 6.

In determining the disaggregation of fees and commissions the Group has considered how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors, including those that are impacted by climate-related factors. It has determined that the above disaggregation by product type provides useful information that does not aggregate items that have substantially different characteristics and is not too detailed.

At 31 December 2022, the Group held on its balance sheet £28 million (31 December 2021: £22 million) in respect of services provided to customers. There were no unsatisfied performance obligations at 31 December 2021 or 31 December 2022.

The most significant performance obligations undertaken by the Group are in respect of current accounts, the provision of other banking services for commercial customers and credit and debit card services.

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.

Note 6: Net trading income

	2022 £m	2021 £m
Foreign exchange	**48**	16
Hedging and other gains	**11**	40
Net trading income	**59**	56

Note 7: Other operating income

	2022 £m	2021 £m
Gains less losses on disposal of financial assets at fair value through other comprehensive income (note 29)	**(15)**	–
Liability management	**11**	7
Intercompany recharges and other	**56**	17
Total other operating income	**52**	24

Note 8: Operating expenses

	2022 £m	2021 £m
Staff costs:		
Salaries	**823**	849
Social security costs	**90**	94
Pensions and other post-retirement benefit schemes (note 23)	**153**	206
	1,066	1,149
Premises and equipment costs:		
Rent and rates	**50**	57
Repairs and maintenance	**32**	44
Other	**91**	40
	173	141
Other expenses:		
Communications and data processing	**79**	95
Advertising and promotion	**42**	44
Professional fees	**11**	15
Regulatory and legal provisions (note 25)	**91**	982
Amounts payable to fellow Lloyds Banking Group undertakings and other	**1,467**	1,140
	1,690	2,276
Depreciation and amortisation:		
Depreciation of property, plant and equipment[1]	**160**	187
Amortisation of other intangible assets	**64**	97
	224	284
Total operating expenses	**3,153**	3,850

1 Comprising depreciation in respect of premises £47 million (2021: £49 million), equipment £35 million (2021: £53 million) and right-of-use assets £78 million (2021: £85 million).

Average headcount

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2022	2021
UK	**23,173**	25,123
Overseas	**389**	410
Total	**23,562**	25,533

Note 9: Auditors' remuneration

Fees payable to the Company's auditors[1] are as follows:

	2022 £m	2021 £m
Fees payable for the:		
– the audit of the Company's current year Annual Report	**1.9**	1.8
– the audits of the Company's subsidiaries	**4.4**	5.4
– total audit fees in respect of the statutory audit of Group entities[2]	**6.3**	7.2
– services normally provided in connection with statutory and regulatory filings or engagements	**0.4**	0.4
Total audit fees[3]	**6.7**	7.6
Other audit-related fees[3]	**0.2**	–
All other fees[3]	**0.1**	0.2
Total non-audit services[4]	**0.3**	0.2
Total fees payable to the Company's auditors by the Group	**7.0**	7.8

1 Deloitte LLP became the Group's statutory auditor in 2021. PricewaterhouseCoopers LLP was the statutory auditor during 2020.
2 As defined by the Financial Reporting Council (FRC).
3 As defined by the Securities and Exchange Commission (SEC).
4 As defined by the SEC. Total non-audit services as defined by the FRC include all fees other than audit fees in respect of the statutory audit of Group entities. These fees totalled £0.7 million (2021 £0.6 million).

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 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.

All other fees: This category includes other assurance services not related to the performance of the audit or review of the financial statements, for example, the review of controls operated by the Group on behalf of a third party. The auditors are not engaged to provide tax services.

It is the Group's policy to use the auditors only 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.

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 Lloyds Banking Group Audit Committee on an individual engagement basis; for certain types of non-audit engagements where the fee is 'de minimis' the Lloyds Banking Group Audit Committee has pre-approved all assignments subject to confirmation by management. On a quarterly basis, the Lloyds Banking Group 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 £0.1 million (2021: £0.1 million) payable by entities outside the consolidated HBOS Group in respect of audits of the Group pension schemes.

Note 10: Impairment

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2022				
Impact of transfers between stages	**(20)**	**250**	**292**	**522**
Other changes in credit quality	**(174)**	**(6)**	**329**	**149**
Additions and repayments	**38**	**(4)**	**(73)**	**(39)**
Other items	**(1)**	**(1)**	**–**	**(2)**
	(137)	**(11)**	**256**	**108**
Total impairment (credit) charge	**(157)**	**239**	**548**	**630**
In respect of:				
Loans and advances to customers	**(169)**	**212**	**548**	**591**
Due from fellow Lloyds Banking Group undertakings	**9**	**–**	**–**	**9**
Financial assets at amortised cost	**(160)**	**212**	**548**	**600**
Loan commitments and financial guarantees	**3**	**27**	**–**	**30**
Total impairment (credit) charge	**(157)**	**239**	**548**	**630**

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2021				
Impact of transfers between stages	25	(128)	142	39
Other changes in credit quality	(107)	(124)	69	(162)
Additions and repayments	(41)	(125)	(88)	(254)
Other items	2	1	–	3
	(146)	(248)	(19)	(413)
Total impairment (credit) charge	(121)	(376)	123	(374)
In respect of:				
Loans and advances to customers	(94)	(336)	128	(302)
Due from fellow Lloyds Banking Group undertakings	–	–	–	–
Financial assets at amortised cost	(94)	(336)	128	(302)
Loan commitments and financial guarantees	(27)	(40)	(5)	(72)
Total impairment (credit) charge	(121)	(376)	123	(374)

The Group's impairment charge comprises the following items:

Impact of 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 and 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 resulting from the repayments of outstanding balances that have been provided against.

Movements in the Group's impairment allowances are shown in note 13.

Note 11: Tax expense

(A) Analysis of tax expense for the year

	2022 £m	2021 £m
UK corporation tax:		
Current tax on profit for the year	**(245)**	(576)
Adjustments in respect of prior years	**176**	17
	(69)	(559)
Foreign tax:		
Current tax on profit for the year	**–**	–
Adjustments in respect of prior years	**(1)**	8
	(1)	8
Current tax expense	**(70)**	(551)
Deferred tax:		
Current year	**(53)**	168
Adjustments in respect of prior years	**54**	(44)
Deferred tax credit	**1**	124
Tax expense	**(69)**	(427)

(B) Factors affecting tax expense for the year

The UK corporation tax rate for the year was 19.0 per cent (2021: 19.0 per cent). An explanation of the relationship between tax expense and accounting profit is set out below:

	2022 £m	2021 £m
Profit before tax	**1,209**	2,271
UK corporation tax thereon	**(230)**	(431)
Impact of surcharge on banking profits	**(86)**	(239)
Non-deductible costs: conduct charges	**(2)**	(155)
Non-deductible costs: bank levy	**(11)**	(8)
Other non-deductible costs	**(6)**	(21)
Non-taxable income	**1**	5
Tax relief on coupons on other equity instruments	**23**	21
Remeasurement of deferred tax due to rate changes	**10**	420
Differences in overseas tax rates	**3**	–
Adjustments in respect of prior years	**229**	(19)
Tax expense	**(69)**	(427)

Note 12: Derivative financial instruments

The fair values and notional amounts of derivative instruments are set out in the following table:

The Group	2022 Contract/ notional amount £m	2022 Fair value assets £m	2022 Fair value liabilities £m	2021 Contract/ notional amount £m	2021 Fair value assets £m	2021 Fair value liabilities £m
Trading and other						
Exchange rate contracts:						
Spot, forwards and futures	**183**	**6**	**2**	273	3	5
Currency swaps	**9,701**	**234**	**487**	10,044	85	326
Options purchased	**15**	**–**	**–**	5	–	–
Options written	**15**	**–**	**–**	5	–	–
	9,914	**240**	**489**	10,327	88	331
Interest rate contracts:						
Interest rate swaps	**58,461**	**3,121**	**3,909**	64,661	3,794	3,587
Options purchased	**60**	**3**	**–**	100	1	–
Options written	**67**	**–**	**4**	119	–	1
	58,588	**3,124**	**3,913**	64,880	3,795	3,588
Credit derivatives	**1,292**	**38**	**–**	2,017	10	24
Equity and other contracts	**38**	**10**	**141**	44	11	166
Total derivative assets/liabilities – trading and other	**69,832**	**3,412**	**4,543**	77,268	3,904	4,109
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**1,291**	**65**	**1**	2,823	280	48
Total derivative assets/liabilities – hedging	**1,291**	**65**	**1**	2,823	280	48
Total recognised derivative assets/liabilities	**71,123**	**3,477**	**4,544**	80,091	4,184	4,157

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 38 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 38

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 12: Derivative financial instruments (continued)

Details of the Group's hedging instruments are set out below:

The Group At 31 December 2022	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						
Interest rate swap						
Notional	**–**	**–**	**155**	**886**	**250**	**1,291**
Average fixed interest rate	**–**	**–**	**7.07%**	**4.63%**	**6.00%**	
At 31 December 2021						
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	85	28	1,095	1,309	306	2,823
Average fixed interest rate	4.25%	4.38%	4.69%	4.94%	5.67%	

The carrying amounts of the Group's hedging instruments are as follows:

The Group At 31 December 2022	Carrying amount of the hedging instrument Contract/ notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness £m
Fair value hedges				
Interest rate				
Interest rate swaps	**1,291**	**65**	**1**	**(170)**
Cash flow hedges				
Interest rate				
Interest rate swaps	**–**	**–**	**–**	**–**
At 31 December 2021				
Fair value hedges				
Interest rate				
Interest rate swaps	2,823	280	48	(190)
Cash flow hedges				
Interest rate				
Interest rate swaps	–	–	–	(43)

All amounts are held within derivative financial instruments.

Note 12: Derivative financial instruments (continued)

The Group's hedged items are as follows:

The Group At 31 December 2022	Carrying amount of the hedged item		Accumulated amount of fair value adjustment on the hedged item		Change in fair value of hedged item for ineffectiveness assessment	Cash flow hedging reserve	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m	Continuing hedges £m	Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**–**	**1,311**	**–**	**35**	**194**		
Fixed rate bonds[2]	**–**	**–**	**–**	**–**	**(24)**		
Cash flow hedges							
Interest rate							
Customer loans[3]					**–**	**–**	**(113)**
Customer deposits[4]					**–**	**–**	**23**
At 31 December 2021							
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	–	2,570	–	212	215		
Fixed rate bonds[2]	660	–	(2)	–	(22)		
Cash flow hedges							
Interest rate							
Customer loans[3]					53	–	(113)
Customer deposits[4]					(11)	–	23

1 Included within debt securities in issue.
2 Included within financial assets at fair value through other comprehensive income.
3 Included within loans and advances to customers.
4 Included within customer deposits.

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 £39 million (2021: liability of £39 million).

Gains and losses arising from hedge accounting are summarised as follows:

The Group At 31 December 2022	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
Cash flow hedges				
Interest rate				
Customer loans	**14**	**–**	**(14)**	**Interest income**
Customer deposits	**(3)**	**–**	**3**	**Interest expense**
At 31 December 2021				
Cash flow hedges				
Interest rate				
Customer loans	(68)	(4)	24	Interest income
Customer deposits	20	1	(5)	Interest expense

1 Hedge ineffectiveness is included in the income statement within net trading income.

There were no amounts reclassified from the cash flow hedging reserve in 2021 or 2022 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

At 31 December 2022 £3,258 million of total recognised derivative assets of the Group and £4,464 million of total recognised derivative liabilities of the Group (2021: £4,076 million of assets and £4,022 million of liabilities) had a contractual residual maturity of greater than one year.

Note 12: Derivative financial instruments (continued)

The Company	2022 Contract/ notional amount £m	2022 Fair value assets £m	2022 Fair value liabilities £m	2021 Contract/ notional amount £m	2021 Fair value assets £m	2021 Fair value liabilities £m
Trading and other						
Interest rate contracts:						
Interest rate swaps	**9**	**–**	**–**	489	82	80
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**546**	**27**	**–**	523	81	–
Total recognised derivative assets/liabilities	**555**	**27**	**–**	1,012	163	80

Details of the Company's hedging instruments are set out below:

The Company At 31 December 2022	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						
Interest rate swap						
Notional	**–**	**–**	**155**	**391**	**–**	**546**
Average fixed interest rate	**–**	**–**	**7.07%**	**4.50%**	**–**	
At 31 December 2021						
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	–	–	518	5	523
Average fixed interest rate	–	–	–	5.23%	7.88%	

The carrying amounts of the Company's hedging instruments are as follows:

The Company At 31 December 2022	Carrying amount of the hedging instrument Contract/ notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness £m
Fair value hedges				
Interest rate				
Interest rate swaps	**546**	**27**	**–**	**(54)**
At 31 December 2021				
Fair value hedges				
Interest rate				
Interest rate swaps	523	81	–	(38)

All amounts are held within derivative financial instruments.

Note 12: Derivative financial instruments (continued)

The Company's hedged items are as follows:

The Company At 31 December 2022	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 £m
Fair value hedges					
Interest rate					
Fixed rate issuance[1]	**–**	**528**	**–**	**8**	**53**
At 31 December 2021					
Fair value hedges					
Interest rate					
Fixed rate issuance[1]	–	531	–	38	41

1 Included within debt securities in issue.

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 £2 million (2021: liability of £3 million).

Gains and losses arising from hedge accounting are summarised as follows:

The Company	Hedge ineffectiveness recognised in the income statement[1] 2022 £m	2021 £m
Fair value hedges		
Interest rate		
Fixed rate issuance	**(1)**	3

1 Hedge ineffectiveness is included in the income statement within net trading income.

There were no amounts reclassified from the cash flow hedging reserve in 2021 or 2022 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

At 31 December 2022 £19 million of total recognised derivative assets of the Company and £nil of total recognised derivative liabilities of the Company (2021: £163 million of assets and £80 million of liabilities) had a contractual residual maturity of greater than one year.

Note 13: Financial assets at amortised cost

Year ended 31 December 2022

The Group	Gross carrying amount Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loans and advances to banks								
At 31 December 2022	271	–	–	271	–	–	–	–
Allowance for impairment losses	–	–	–	–				
Net carrying amount	271	–	–	271				
Loans and advances to customers								
At 1 January 2022	250,007	26,420	5,561	281,988	392	810	1,377	2,579
Exchange and other adjustments	8	–	–	8	–	–	55	55
Acquisition of business[1]	5,345	875	125	6,345	61	110	57	228
Transfers to Stage 1	5,473	(5,422)	(51)	–	75	(71)	(4)	–
Transfers to Stage 2	(24,077)	24,327	(250)	–	(31)	64	(33)	–
Transfers to Stage 3	(498)	(2,722)	3,220	–	(5)	(163)	168	–
Impact of transfers between stages	(19,102)	16,183	2,919	–	(57)	401	161	505
					(18)	231	292	505
Other changes in credit quality					(187)	(14)	329	128
Additions and repayments	7,615	748	(835)	7,528	36	(5)	(73)	(42)
Charge (credit) to the income statement					(169)	212	548	591
Advances written off			(350)	(350)			(350)	(350)
Recoveries of advances written off in previous years			94	94			94	94
At 31 December 2022	243,873	44,226	7,514	295,613	284	1,132	1,781	3,197
Allowance for impairment losses	(284)	(1,132)	(1,781)	(3,197)				
Net carrying amount	243,589	43,094	5,733	292,416				
Drawn ECL coverage[2] (%)	0.1	2.6	23.7	1.1				
Due from fellow Lloyds Banking Group undertakings								
At 31 December 2022	13,993	–	–	13,993	11	–	–	11
Allowance for impairment losses	(11)	–	–	(11)				
Net carrying amount	13,982	–	–	13,982				
Total financial assets at amortised cost	257,842	43,094	5,733	306,669				

1 On 30 November 2022 the Group acquired MBNA Limited, formerly a subsidiary of Lloyds Bank plc, a fellow Lloyds Banking Group undertaking.
2 Allowance for expected credit losses on loans and advances to customers as a percentage of gross loans and advances to customers.

Note 13: Financial assets at amortised cost (continued)

Movements in allowance for expected credit losses in respect of undrawn balances were as follows:

	Allowance for expected credit losses			
The Group	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Undrawn balances				
At 1 January 2022	**26**	**29**	**1**	**56**
Exchange and other adjustments	**–**	**–**	**–**	**–**
Acquisition of business[1]	**24**	**5**	**–**	**29**
Transfers to Stage 1	**8**	**(8)**	**–**	**–**
Transfers to Stage 2	**(3)**	**3**	**–**	**–**
Transfers to Stage 3	**–**	**(1)**	**1**	**–**
Impact of transfers between stages	**(7)**	**25**	**(1)**	**17**
	(2)	**19**	**–**	**17**
Other items taken to the income statement	**5**	**8**	**–**	**13**
Charge to the income statement	**3**	**27**	**–**	**30**
At 31 December 2022	**53**	**61**	**1**	**115**

1 On 30 November 2022 the Group acquired MBNA Limited, formerly a subsidiary of Lloyds Bank plc, a fellow Lloyds Banking Group undertaking.

The Group's total impairment allowances were as follows:

	Allowance for expected credit losses			
The Group	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
In respect of:				
Loans and advances to customers	**284**	**1,132**	**1,781**	**3,197**
Due from fellow Lloyds Banking Group undertakings	**11**	**–**	**–**	**11**
Other assets	**–**	**–**	**1**	**1**
Drawn balances	**295**	**1,132**	**1,782**	**3,209**
Provisions in relation to loan commitments and financial guarantees	**53**	**61**	**1**	**115**
Total	**348**	**1,193**	**1,783**	**3,324**

Note 13: Financial assets at amortised cost (continued)

Year ended 31 December 2021

The Group	Gross carrying amount Stage 1 £m	Gross carrying amount Stage 2 £m	Gross carrying amount Stage 3 £m	Gross carrying amount Total £m	Allowance for expected credit losses Stage 1 £m	Allowance for expected credit losses Stage 2 £m	Allowance for expected credit losses Stage 3 £m	Allowance for expected credit losses Total £m
Loans and advances to banks								
At 31 December 2021	102	–	–	102	–	–	–	–
Allowance for impairment losses	–	–	–	–				
Net carrying amount	102	–	–	102				
Loans and advances to customers								
At 1 January 2021	226,746	34,437	5,775	266,958	486	1,146	1,560	3,192
Exchange and other adjustments	(32)	–	(31)	(63)	–	–	9	9
Transfers to Stage 1	9,790	(9,779)	(11)	–	210	(206)	(4)	–
Transfers to Stage 2	(6,399)	7,171	(772)	–	(19)	108	(89)	–
Transfers to Stage 3	(309)	(1,356)	1,665	–	(6)	(118)	124	–
Impact of transfers between stages	3,082	(3,964)	882	–	(160)	100	110	50
					25	(116)	141	50
Other changes in credit quality					(83)	(107)	75	(115)
Additions and repayments	20,211	(4,053)	(745)	15,413	(36)	(113)	(88)	(237)
(Credit) charge to the income statement					(94)	(336)	128	(302)
Advances written off			(382)	(382)			(382)	(382)
Recoveries of advances written off in previous years			62	62			62	62
At 31 December 2021	250,007	26,420	5,561	281,988	392	810	1,377	2,579
Allowance for impairment losses	(392)	(810)	(1,377)	(2,579)				
Net carrying amount	249,615	25,610	4,184	279,409				
Drawn ECL coverage (%)	0.2	3.1	24.8	0.9				
Due from fellow Lloyds Banking Group undertakings								
At 31 December 2021	15,183	–	–	15,183	2	–	–	2
Allowance for impairment losses	(2)	–	–	(2)				
Net carrying amount	15,181	–	–	15,181				
Total financial assets at amortised cost	264,898	25,610	4,184	294,692				

Note 13: Financial assets at amortised cost (continued)

Movements in allowance for expected credit losses in respect of undrawn balances were as follows:

The Group	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Undrawn balances				
At 1 January 2021	54	69	6	129
Exchange and other adjustments	(1)	–	–	(1)
Transfers to Stage 1	20	(20)	–	–
Transfers to Stage 2	(3)	3	–	–
Transfers to Stage 3	–	(2)	2	–
Impact of transfers between stages	(17)	7	(1)	(11)
	–	(12)	1	(11)
Other items taken to the income statement	(27)	(28)	(6)	(61)
Credit to the income statement	(27)	(40)	(5)	(72)
At 31 December 2021	26	29	1	56

The Group's total impairment allowances were as follows:

The Group	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of:				
Loans and advances to customers	392	810	1,377	2,579
Due from fellow Lloyds Banking Group undertakings	2	–	–	2
Other assets	–	–	1	1
Drawn balances	394	810	1,378	2,582
Provisions in relation to loan commitments and financial guarantees	26	29	1	56
Total	420	839	1,379	2,638

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.

Additions and 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.

At 31 December 2022 £174 million (2021: £44 million) of loans and advances to banks of the Group had a contractual residual maturity of greater than one year.

At 31 December 2022 £274,927 million (2021: £262,405 million) of loans and advances to customers of the Group had a contractual residual maturity of greater than one year.

At 31 December 2022 the Company had financial assets at amortised cost of £3,209 million (2021: £2,655 million), representing amounts due from fellow Lloyds Banking Group undertakings, all of which was Stage 1.

Note 14: Allowance for expected credit losses

The calculation of the Group's expected credit loss allowances and provisions against loan commitments and guarantees, which are set out in note 13, 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. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due which the Group now uses for all its products following changes to the definition of default for UK mortgages on 1 January 2022. In addition, other indicators of mortgage default were added including end-of-term payments on past due interest-only accounts and loans considered non-performing due to recent arrears or forbearance, aligning the definition of Stage 3 credit-impaired for IFRS 9 to the CRD IV prudential regulatory definition of default. This change in definition of default contributes to the £1.5 billion increase in Stage 3 loans and advances to customers during the period.

Lifetime of an exposure

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, extensions 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 revolving retail 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. The assessment of SICR and corresponding lifetime loss, and the PD, of a financial asset designated as Stage 2, or Stage 3, is dependent on its expected life.

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. Credit-impaired assets are transferred to Stage 3 with a lifetime expected losses allowance. The Group uses both quantitative and qualitative indicators to determine whether there has been a SICR for an asset. For Retail, the following tables set out the retail master scale (RMS) grade triggers which result in a SICR for financial assets and the PD boundaries for each RMS grade.

SICR triggers for key retail portfolios

Origination grade	1	2	3	4	5	6	7
Mortgages SICR grade	5	5	6	7	8	9	10
Credit cards, loans and overdrafts SICR grade	4	5	6	7	8	9	10

RMS grade	1	2	3	4	5	6	7	8	9	10	11	12	13	14
PD boundary %[1]	0.10	0.40	0.80	1.20	2.50	4.50	7.50	10.00	14.00	20.00	30.00	45.00	99.99	100.00

1 Probability-weighted annualised lifetime probability of default.

For commercial exposures 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.

The Group uses the internal credit risk classification and watchlist as qualitative indicators to identify a SICR. The Group does not use the low credit risk exemption in its staging assessments. The use of a payment holiday in and of itself has not been judged to indicate a significant increase in credit risk, nor forbearance, with the underlying long-term credit risk deemed to be driven by economic conditions and captured through the use of forward-looking models. These portfolio level models are capturing the anticipated volume of increased defaults and therefore an appropriate assessment of staging and expected credit loss.

All financial assets are assumed to have suffered a SICR if they are more than 30 days past due; credit cards, loans and overdrafts financial assets are also assumed to have suffered a SICR if they are in arrears on three or more separate occasions in a rolling 12-month period. Financial assets are classified as credit-impaired if they are 90 days past due.

A Stage 3 asset that is no longer credit-impaired is transferred back to Stage 2 as no cure period is applied to Stage 3. UK mortgages is an exception to this rule where a probation period is enforced for non-performing, forborne and defaulted exposures in accordance with prudential regulation. If an exposure that is classified as Stage 2 no longer meets the SICR criteria, which in some cases capture customer behaviour in previous periods, it is moved back to Stage 1.

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.

Note 14: Allowance for expected credit losses (continued)

Generation of multiple economic scenarios

The estimate of expected credit losses is required to be based on an unbiased expectation of future economic scenarios. The approach used to generate the range of future economic scenarios depends on the methodology and judgements adopted. The Group's approach is to start from a defined base case scenario, used for planning purposes, and to generate alternative economic scenarios around this base case. The base case scenario is a conditional forecast underpinned by a number of conditioning assumptions that reflect the Group's best view of key future developments. If circumstances appear likely to materially deviate from the conditioning assumptions, then the base case scenario is updated.

The base case scenario is central to a range of future economic scenarios generated by simulation of an economic model, for which the same conditioning assumptions apply as in the base case scenario. These scenarios are ranked by using estimated relationships with industry-wide historical loss data. With the base case already pre-defined, three other scenarios are identified as averages of constituent scenarios located around the 15th, 75th and 95th percentiles of the distribution. The full distribution is therefore summarised by a practical number of scenarios to run through ECL models representing an upside, the base case, and a downside scenario weighted at 30 per cent each, together with a severe downside scenario weighted at 10 per cent. The scenario weights represent the distribution of economic scenarios and not subjective views on likelihood. The inclusion of a severe downside scenario with a smaller weighting ensures that the non-linearity of losses in the tail of the distribution is adequately captured. Macroeconomic projections may employ reversionary techniques to adjust the paths of economic drivers towards long-run equilibria after a reasonable forecast horizon. The Group does not use such techniques to force the MES scenarios to revert to the base case planning view. Utilising such techniques would be expected to be immaterial for expected credit losses since loss sensitivity is highest over the initial five years of the projections. Most assets are expected to have matured, or reached the end of their behavioural life before the five-year horizon.

A forum under the chairmanship of the Chief Economist meets at least quarterly to review and, if appropriate, recommend changes to the method by which economic scenarios are generated, for approval by the Chief Financial Officer and Chief Risk Officer. In June 2022, the Group judged it appropriate to include an adjusted severe downside scenario to incorporate a high CPI inflation and UK Bank Rate profiles and to adopt this adjusted severe downside scenario to calculate the Group's ECL. This is because the historic macroeconomic and loan loss data upon which the scenario model is calibrated imply an association of downside economic outcomes with easier monetary policy, and therefore low interest rates. The adjustment is considered to better reflect the risks around the Group's base case view in an economic environment where supply shocks are the principal concern. The Group has continued to include a non-modelled severe downside scenario for Group ECL calculations for 31 December 2022 reporting.

Base case and MES economic assumptions

The Group's base case economic scenario has been revised in light of the ongoing war in Ukraine, reversals in UK fiscal policy, and a continuing global shift towards a more restrictive monetary policy stance against a backdrop of elevated inflation pressures. The Group's updated base case scenario has three conditioning assumptions: first, the war in Ukraine remains 'local', i.e. without overtly involving neighbouring countries, NATO or China; second, the UK labour market participation rate remains below pre-pandemic levels, impeding the economy's supply capacity; and third, the Bank of England accommodates above-target inflation in the medium term, recognising the economic costs that might arise from a rapid return to the two per cent target.

Based on these assumptions and incorporating the economic data published in the fourth quarter, the Group's base case scenario is for a contraction in economic activity and a rise in the unemployment rate alongside declines in residential and commercial property prices, following increases in UK Bank Rate in response to persistent inflationary pressures. Risks around this base case economic view lie in both directions and are largely captured by the generation of alternative economic scenarios.

The Group has accommodated the latest available information at the reporting date in defining its base case scenario and generating alternative economic scenarios. The scenarios include forecasts for key variables in the fourth quarter of 2022, for which actuals may have since emerged prior to publication.

Scenarios by year

The key UK economic assumptions made by the Group are shown in the following tables across a number of measures explained below.

Annual assumptions

Gross domestic product (GDP) and Consumer Price Index (CPI) inflation are presented as an annual change, house price growth and commercial real estate price growth are presented as the growth in the respective indices over each year. Unemployment rate and UK Bank Rate are averages over the year.

Five-year average

The five-year average reflects the average annual growth rate, or level, over the five-year period. It includes movements within the current reporting year, such that the position as of 31 December 2022 covers the five years 2022 to 2026. The inclusion of the reporting year within the five-year period reflects the need to predict variables which remain unpublished at the reporting date and recognises that credit models utilise both level and annual changes. The use of calendar years maintains a comparability between the annual assumptions presented.

Five-year start to peak and trough

The peak or trough for any metric may occur intra year and therefore not be identifiable from the annual assumptions, therefore they are also disclosed. For GDP, house price growth and commercial real estate price growth, the peak, or trough, reflects the highest, or lowest cumulative quarterly position reached relative to the start of the five-year period, which as of 31 December 2022 is 1 January 2022. Given these metrics may exhibit increases followed by greater falls, the start to trough movements quoted may be smaller than the equivalent 'peak to trough' movement (and vice versa for start to peak). Unemployment, UK Bank Rate and CPI Inflation reflect the highest, or lowest, quarterly level reached in the five-year period.

Note 14: Allowance for expected credit losses (continued)

At 31 December 2022	2022 %	2023 %	2024 %	2025 %	2026 %	2022 to 2026 average %	Start to peak[1] %	Start to trough[1] %
Upside								
Gross domestic product	4.1	0.1	1.1	1.7	2.1	1.8	6.5	0.4
Unemployment rate	3.5	2.8	3.0	3.3	3.4	3.2	3.8	2.8
House price growth	2.4	(2.8)	6.5	9.0	8.0	4.5	24.8	(1.1)
Commercial real estate price growth	(9.4)	8.5	3.5	2.6	2.3	1.3	7.2	(9.4)
UK Bank Rate	1.94	4.95	4.98	4.63	4.58	4.22	5.39	0.75
CPI inflation	9.0	8.3	4.2	3.3	3.0	5.5	10.7	2.9
Base case								
Gross domestic product	4.0	(1.2)	0.5	1.6	2.1	1.4	4.3	(1.1)
Unemployment rate	3.7	4.5	5.1	5.3	5.1	4.8	5.3	3.6
House price growth	2.0	(6.9)	(1.2)	2.9	4.4	0.2	6.4	(6.3)
Commercial real estate price growth	(11.8)	(3.3)	0.9	2.8	3.1	(1.8)	7.2	(14.8)
UK Bank Rate	1.94	4.00	3.38	3.00	3.00	3.06	4.00	0.75
CPI inflation	9.0	8.3	3.7	2.3	1.7	5.0	10.7	1.6
Downside								
Gross domestic product	3.9	(3.0)	(0.5)	1.4	2.1	0.8	1.2	(3.6)
Unemployment rate	3.8	6.3	7.5	7.6	7.2	6.5	7.7	3.6
House price growth	1.6	(11.1)	(9.8)	(5.6)	(1.5)	(5.4)	6.4	(24.3)
Commercial real estate price growth	(13.9)	(15.0)	(3.7)	0.4	1.4	(6.4)	7.2	(29.6)
UK Bank Rate	1.94	2.93	1.39	0.98	1.04	1.65	3.62	0.75
CPI inflation	9.0	8.2	3.3	1.3	0.3	4.4	10.7	0.2
Severe downside								
Gross domestic product	3.7	(5.2)	(1.0)	1.3	2.1	0.1	0.7	(6.4)
Unemployment rate	4.1	9.0	10.7	10.4	9.7	8.8	10.7	3.6
House price growth	1.1	(14.8)	(18.0)	(11.5)	(4.2)	(9.8)	6.4	(40.1)
Commercial real estate price growth	(17.3)	(28.8)	(9.9)	(1.3)	3.2	(11.6)	7.2	(47.8)
UK Bank Rate – modelled	1.94	1.41	0.20	0.13	0.14	0.76	3.50	0.12
UK Bank Rate – adjusted[2]	2.44	7.00	4.88	3.31	3.25	4.18	7.00	0.75
CPI inflation – modelled	9.0	8.2	2.6	(0.1)	(1.6)	3.6	10.7	(1.7)
CPI inflation – adjusted[2]	9.7	14.3	9.0	4.1	1.6	7.7	14.8	1.5
Probability-weighted								
Gross domestic product	4.0	(1.8)	0.2	1.5	2.1	1.2	3.4	(1.8)
Unemployment rate	3.7	5.0	5.8	5.9	5.7	5.2	5.9	3.6
House price growth	1.9	(7.7)	(3.2)	0.7	2.9	(1.2)	6.4	(9.5)
Commercial real estate price growth	(12.3)	(5.8)	(0.8)	1.6	2.3	(3.1)	7.2	(18.6)
UK Bank Rate – modelled	1.94	3.70	2.94	2.59	2.60	2.76	3.89	0.75
UK Bank Rate – adjusted[2]	1.99	4.26	3.41	2.91	2.91	3.10	4.31	0.75
CPI inflation – modelled	9.0	8.3	3.6	2.1	1.4	4.9	10.7	1.3
CPI inflation – adjusted[2]	9.1	8.9	4.3	2.5	1.7	5.3	11.0	1.6

1 Since the level of property prices peaked during 2022, peak to trough declines for house price growth and commercial real estate price growth are larger than the start to trough declines over the period shown.

2 The adjustment to UK Bank Rate and CPI inflation in the severe downside is considered to better reflect the risks around the Group's base case view in an economic environment where supply shocks are the principal concern.

Base case scenario by quarter[1] At 31 December 2022	First quarter 2022 %	Second quarter 2022 %	Third quarter 2022 %	Fourth quarter 2022 %	First quarter 2023 %	Second quarter 2023 %	Third quarter 2023 %	Fourth quarter 2023 %
Gross domestic product	0.6	0.1	(0.3)	(0.4)	(0.4)	(0.4)	(0.2)	(0.1)
Unemployment rate	3.7	3.8	3.6	3.7	4.0	4.4	4.7	4.9
House price growth	11.1	12.5	9.8	2.0	(3.0)	(8.4)	(9.8)	(6.9)
Commercial real estate price growth	18.0	18.0	8.4	(11.8)	(16.9)	(19.8)	(15.9)	(3.3)
UK Bank Rate	0.75	1.25	2.25	3.50	4.00	4.00	4.00	4.00
CPI inflation	6.2	9.2	10.0	10.7	10.0	8.9	8.0	6.1

1 Gross domestic product is presented quarter-on-quarter. House price growth, commercial real estate growth and CPI inflation are presented year-on-year, i.e. from the equivalent quarter in the previous year. Unemployment rate and UK Bank Rate are presented as at the end of each quarter.

Note 14: Allowance for expected credit losses (continued)

At 31 December 2021	2021 %	2022 %	2023 %	2024 %	2025 %	2021-2025 average %	Start to peak %	Start to trough %
Upside								
Gross domestic product	7.1	4.0	1.4	1.3	1.4	3.0	12.6	(1.3)
Unemployment rate	4.4	3.3	3.4	3.5	3.7	3.7	4.9	3.2
House price growth	10.1	2.6	4.9	4.7	3.6	5.1	28.5	1.2
Commercial real estate price growth	12.4	5.8	0.7	1.0	(0.6)	3.7	20.9	0.8
UK Bank Rate	0.14	1.44	1.74	1.82	2.03	1.43	2.04	0.10
CPI inflation[1]	2.6	5.9	3.3	2.6	3.3	3.5	6.5	0.6
Base case								
Gross domestic product	7.1	3.7	1.5	1.3	1.3	2.9	12.3	(1.3)
Unemployment rate	4.5	4.3	4.4	4.4	4.5	4.4	4.9	4.3
House price growth	9.8	0.0	0.0	0.5	0.7	2.1	11.0	1.2
Commercial real estate price growth	10.2	(2.2)	(1.9)	0.1	0.6	1.2	10.2	0.8
UK Bank Rate	0.14	0.81	1.00	1.06	1.25	0.85	1.25	0.10
CPI inflation[1]	2.6	5.9	3.0	1.6	2.0	3.0	6.5	0.6
Downside								
Gross domestic product	7.1	3.4	1.3	1.1	1.2	2.8	11.4	(1.3)
Unemployment rate	4.7	5.6	5.9	5.8	5.7	5.6	6.0	4.3
House price growth	9.2	(4.9)	(7.8)	(6.6)	(4.7)	(3.1)	9.2	(14.8)
Commercial real estate price growth	8.6	(10.1)	(7.0)	(3.4)	(0.3)	(2.6)	8.6	(12.8)
UK Bank Rate	0.14	0.45	0.52	0.55	0.69	0.47	0.71	0.10
CPI inflation[1]	2.6	5.8	2.8	1.3	1.6	2.8	6.4	0.6
Severe downside								
Gross domestic product	6.8	0.9	0.4	1.0	1.4	2.1	7.6	(1.3)
Unemployment rate	4.9	7.7	8.5	8.1	7.6	7.3	8.5	4.3
House price growth	9.1	(7.3)	(13.9)	(12.5)	(8.4)	(6.9)	9.1	(30.2)
Commercial real estate price growth	5.8	(19.6)	(12.1)	(5.3)	(0.5)	(6.8)	6.9	(30.0)
UK Bank Rate	0.14	0.04	0.06	0.08	0.09	0.08	0.25	0.02
CPI inflation[1]	2.6	5.8	2.3	0.5	0.9	2.4	6.5	0.4
Probability-weighted								
Gross domestic product	7.0	3.4	1.3	1.2	1.3	2.8	11.6	(1.3)
Unemployment rate	4.6	4.7	5.0	5.0	4.9	4.8	5.0	4.3
House price growth	9.6	(1.4)	(2.3)	(1.7)	(1.0)	0.6	9.6	1.2
Commercial real estate price growth	9.9	(3.9)	(3.7)	(1.2)	(0.1)	0.1	9.9	(0.3)
UK Bank Rate	0.14	0.82	0.99	1.04	1.20	0.83	1.20	0.10
CPI inflation[1]	2.6	5.9	2.9	1.7	2.2	3.1	6.5	0.6

1 For 31 December 2021 scenarios, CPI numbers were translations of modelled Retail Price Index excluding mortgage interest payments (RPIX) estimates.

Base case scenario by quarter[1] At 31 December 2021	First quarter 2021 %	Second quarter 2021 %	Third quarter 2021 %	Fourth quarter 2021 %	First quarter 2022 %	Second quarter 2022 %	Third quarter 2022 %	Fourth quarter 2022 %
Gross domestic product	(1.3)	5.4	1.1	0.4	0.1	1.5	0.5	0.3
Unemployment rate	4.9	4.7	4.3	4.3	4.4	4.3	4.3	4.3
House price growth	6.5	8.7	7.4	9.8	8.4	6.1	3.2	0.0
Commercial real estate price growth	(2.9)	3.4	7.5	10.2	8.4	5.2	0.9	(2.2)
UK Bank Rate	0.10	0.10	0.10	0.25	0.50	0.75	1.00	1.00
CPI inflation	0.6	2.1	2.8	4.9	5.3	6.5	6.3	5.3

1 Gross domestic product is presented quarter-on-quarter. House price growth, commercial real estate growth and CPI inflation are presented year-on-year, i.e. from the equivalent quarter in the previous year. Unemployment rate and UK Bank Rate are presented as at the end of each quarter.

Note 14: Allowance for expected credit losses (continued)

ECL sensitivity to economic assumptions

The table below shows the Group's ECL for the probability-weighted, upside, base case, downside and severe downside scenarios, with the severe downside scenario incorporating adjustments made to CPI inflation and UK Bank Rate paths. The stage allocation for an asset is based on the overall scenario probability-weighted PD and hence the staging of assets is constant across all the scenarios. In each economic scenario the ECL for individual assessments and post-model adjustments is typically held constant reflecting the basis on which they are evaluated. For 31 December 2022, however, post-model adjustments in Commercial Banking have been apportioned across the scenarios to better reflect the sensitivity of these adjustments to each scenario. Judgements applied through changes to model inputs are reflected in the scenario ECL sensitivities. The probability-weighted view shows the extent to which a higher ECL allowance has been recognised to take account of multiple economic scenarios relative to the base case; the uplift being £440 million compared to £128 million at 31 December 2021.

	At 31 December 2022					At 31 December 2021				
	Probability-weighted £m	Upside £m	Base case £m	Downside £m	Severe downside £m	Probability-weighted £m	Upside £m	Base case £m	Downside £m	Severe downside £m
ECL allowance	**3,324**	**2,482**	**2,884**	**3,602**	**6,340**	2,638	2,385	2,510	2,799	3,295

The table below shows the Group's ECL for the upside, base case, downside and severe downside scenarios, with staging of assets based on each specific scenario probability of default. ECL applied through individual assessments and the majority of post-model adjustments are reported flat against each economic scenario, reflecting the basis on which they are evaluated. A probability-weighted scenario is not shown as this does not reflect the basis on which ECL is reported. Comparing the probability-weighted ECL in the table above to the base case ECL with base case scenario specific staging, as shown in the table below, results in an uplift of £517 million compared to £132 million at 31 December 2021.

	At 31 December 2022				At 31 December 2021			
	Upside £m	Base case £m	Downside £m	Severe downside £m	Upside £m	Base case £m	Downside £m	Severe downside £m
ECL allowance	**2,394**	**2,807**	**3,535**	**10,419**	2,377	2,506	2,813	3,427

The impact of changes in the UK unemployment rate and House Price Index (HPI) have 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 gradual changes in these two critical economic factors. The assessment has been made against the base case with the reported staging unchanged and is assessed through the direct impact on modelled ECL only, including management judgements applied through changes to model inputs. The change in univariate ECL sensitivity in the period is a result of the change in definition of default and associated model changes, and the deterioration in the base case on which the assessment has been performed.

The table below shows the impact on the Group's ECL resulting from a 1 percentage point (pp) increase or decrease in the UK unemployment rate. The increase or decrease is presented based on the adjustment phased evenly over the first ten quarters of the base case scenario. An immediate increase or decrease would drive a more material ECL impact as it would be fully reflected in both 12-month and lifetime PDs.

	At 31 December 2022		At 31 December 2021	
	1pp increase in unemployment	1pp decrease in unemployment	1pp increase in unemployment	1pp decrease in unemployment
ECL impact, £m	**73**	**(70)**	40	(35)

The table below shows the impact on the Group's ECL in respect of UK mortgages of an increase or decrease in loss given default for a 10 percentage point (pp) increase or decrease in the UK House Price Index (HPI). The increase or decrease is presented based on the adjustment phased evenly over the first ten quarters of the base case scenario.

	At 31 December 2022		At 31 December 2021	
	10pp increase in HPI	10pp decrease in HPI	10pp increase in HPI	10pp decrease in HPI
ECL impact, £m	**(207)**	**341**	(106)	154

Note 14: Allowance for expected credit losses (continued)

Individual assessments

The Stage 3 ECL relating to commercial clients is largely assessed on an individual basis using bespoke assessment of loss for each specific client. These assessments are carried out by the Business Support Unit based on detailed reviews and expected recovery strategies. While these assessments are based on the Group's latest economic view, the use of Group-wide multiple economic scenarios and weightings is not considered appropriate for these cases due to their individual characteristics. In place of this, a range of case-specific outcomes are considered with any alternative better or worse outcomes that carry a 25 per cent likelihood taken into account in establishing a probability-weighted ECL.

Application of judgement in adjustments to modelled ECL

Impairment models fall within the Group's model risk framework with model monitoring, periodic validation and back testing performed on model components (i.e. probability of default, exposure at default and loss given default). Limitations in the Group's impairment models or data inputs may be identified through the ongoing 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 that the overall provision adequately reflects all material risks. These adjustments are determined by considering the particular attributes of exposures which have not been adequately captured by the impairment models and range from changes to model inputs and parameters, at account level, through to more qualitative post-model adjustments. Post-model adjustments are not typically assessed under each distinct economic scenario used to generate ECL, but on final modelled ECL. All adjustments are reviewed quarterly and are subject to internal review and challenge, including by the Lloyds Banking Group Audit Committee, to ensure that amounts are appropriately calculated and that there are specific release criteria identified.

The coronavirus pandemic and the various support measures resulted in an economic environment which differed significantly from the historical economic conditions upon which the impairment models had been built. As a result there was a greater need for management judgements to be applied alongside the use of models at 31 December 2021. During 2022 the direct impact of the pandemic on both economic and credit performance has reduced, resulting in the release of all material judgements required specifically to capture COVID-19 risks. Conversely, the intensifying inflationary pressures alongside rising interest rates within the Group's outlook have created further risks not deemed to be fully captured by ECL models. This has required judgements to be added to capture affordability risks from inflationary and rising interest rate pressures. At 31 December 2022 management judgement resulted in additional ECL allowances totalling £402 million (2021: £1,060 million).

The table below analyses total ECL allowance, separately identifying the amounts that have been modelled, those that have been individually assessed and those arising through the application of management judgement.

			Judgements due to:			
	Modelled ECL £m	Individually assessed £m	COVID-19[1] £m	Inflationary risk £m	Other £m	Total ECL £m
At 31 December 2022	**2,045**	**877**	**–**	**137**	**265**	**3,324**
At 31 December 2021	869	709	390	57	613	2,638

1 Judgements introduced to address the impact that COVID-19 and resulting interventions have had on the Group's economic outlook and observed loss experience, which have required additional model limitations to be addressed. In 2021, there was a £240 million other COVID-19 judgement to recognise the risk that the conditioning assumptions assumed in the base case economic scenario were invalidated by future events.

Judgements due to inflationary risk

Inflationary and interest rate pressures: £137 million (2021: £57 million)

There has been only modest evidence of credit deterioration in the UK mortgages portfolio through 2022 despite the high levels of inflation and the rising interest rate environment. Mortgage ECL models use the UK Bank Rate as a driver of predicted defaults and that has contributed to the elevated levels of ECL at 31 December 2022. However, there remains a potential risk to affordability from continued inflationary pressures combined with higher interest rates, and that this may not be fully captured by the Group's ECL models. This risk is to customers maturing from low fixed rate deals, the building impact on variable rate holders and lower levels of real household income.

The level of risk is somewhat mitigated from stressed affordability assessments applied at loan origination which means most customers are anticipated to be able to absorb payment shocks. A judgemental uplift in ECL has therefore been taken in specific segments of the mortgages portfolio, either where inflation is expected to present a more material risk, or where segments within the model do not use bank base rate as a material driver of predicted defaults.

At 31 December 2021 additional judgemental ECL was taken in UK mortgages to recognise the heightened risk of interest rates increasing rapidly compared to the base case outlook. This judgement quantified incremental losses from adopting an alternative severe downside scenario with a 4 per cent interest rate peak. This judgement is no longer required given the Group's base case outlook, and modelled ECL, now captures an equivalent interest rate view within the base case alongside an adjusted severe scenario with a 7 per cent interest rate peak.

Other judgements

These adjustments principally comprise:

Increase in time to repossession: £159 million (2021: £144 million)

Due to the Group suspending mortgage litigation activity between late-2014 and mid-2018 due to policy changes for the treatment of arrears, and as collections strategy normalises post COVID-19 pandemic, the Group's experience of possessions data on which our models rely on is limited. This reflects an adjustment made to allow for an increase in the time assumed between default and repossession. Provision coverage is uplifted to the equivalent levels of those accounts already in repossession on an estimated shortfall of balances expected to flow to possession.

A further adjustment is made to accounts which have been in default for more than 24 months, with an arrears balance increase in the last six months. These accounts have their probability of possession set to 70 per cent based on observed historical losses incurred on accounts that were of an equivalent status. The increase in the judgement reflects a lower modelled coverage that requires a larger adjustment to reach the required levels.

Asset recovery values: £93 million (2021: £33 million)

Due to low repossession volumes, sales data informing the estimated level of discount in the event of repossessions has been limited, impacting the ability to update model parameters. Despite these low volumes, since 2020 the observed asset recovery sale values have remained broadly the same on the limited volumes seen, however the indexed valuation within the model has shown an increasing trend due to HPI increases, therefore management consider it appropriate to uplift ECL to reflect expected recovery values.

Note 14: Allowance for expected credit losses (continued)

Adjustment for specific segments: £27 million (2021: £78 million)

The Group monitors risks across specific segments of its portfolios which may not be fully captured through wider collective models. Judgemental increases applied to probability of default on forborne accounts (31 December 2021: £36 million) have been removed as models now include forborne accounts in Stage 3 assets. The judgement for fire safety and cladding uncertainty has reduced to £27 million (31 December 2021: £42 million). Though experience remains limited the risk is considered sufficiently material to address through judgement, given that there is evidence of assessed cases having defective cladding, or other fire safety issues, but this risk has reduced throughout the year.

Lifetime extension on revolving products: £63 million (2021: £16 million)

An adjustment is required to extend the lifetime used for Stage 2 exposures on unsecured revolving products from a three year modelled lifetime, which reflected the outcome data available. Previously an adjustment was made to extend the lifetime used for Stage 2 exposures to six years by increasing default probabilities through the extrapolation of the default trajectory observed throughout the three years and beyond. During 2022, work was undertaken to reassess the expected lifetime for these assets, which concluded in an extension of the expected lifetime from six to ten years, resulting in an increase to this adjustment.

Adjustments to loss given defaults: £(76) million (2021: £3 million)

A number of adjustments have been made to the loss given default assumptions used within unsecured credit models. These include updates to judgements held previously, notably in relation to the alignment of MBNA credit card cure rates as collection strategies harmonise. Alongside this, new adjustments have also been raised to capture recent improvements in observed cure rates offset by updates to recovery cost assumptions. These adjustments will be released once incorporated into models through future recalibration which is pending model development.

The modelling approach for loss given default for commercial exposures has been reviewed. Management deem ECL should be adjusted to mitigate limitations identified in the approach which are causing loss given defaults to be inflated. These include the benefit from amortisation of exposures relative to collateral values at default and a move to an exposure-weighted approach being adopted. These temporary adjustments will be addressed through future model development.

Note 15: Finance lease and hire purchase receivables

The Group's finance lease and hire purchase receivables are classified as loans and advances to customers and accounted for at amortised cost. These balances are analysed as follows:

	The Group			
	Finance leases		Hire purchase	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Not later than 1 year	**24**	31	**104**	76
Later than 1 year and not later than 2 years	**25**	41	**101**	72
Later than 2 years and not later than 3 years	**25**	30	**91**	65
Later than 3 years and not later than 4 years	**25**	27	**37**	27
Later than 4 years and not later than 5 years	**26**	27	**40**	30
Later than 5 years	**122**	149	**–**	–
Gross investment	**247**	305	**373**	270
Unearned future finance income	**(75)**	(92)	**(34)**	(23)
Rentals received in advance	**–**	–	**–**	–
Net investment	**172**	213	**339**	247

The net investment represents amounts recoverable as follows:

	The Group			
	Finance leases		Hire purchase	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Not later than 1 year	**9**	10	**89**	70
Later than 1 year and not later than 2 years	**12**	27	**90**	66
Later than 2 years and not later than 3 years	**14**	18	**85**	59
Later than 3 years and not later than 4 years	**15**	16	**35**	24
Later than 4 years and not later than 5 years	**17**	18	**40**	28
Later than 5 years	**105**	124	**–**	–
Net investment	**172**	213	**339**	247

Equipment leased to customers under finance leases relates to structured financing transactions to fund the purchase of ships, sea freight transportation and waste water treatment facilities, hire purchase receivables relate to financing transactions to fund the purchase of motor vehicles. There was an allowance for uncollectable finance lease receivables included in the allowance for impairment losses for the Group of £4 million (2021: £1 million) and for hire purchase receivables of £3 million (2021: £3 million).

Note 16: Goodwill

	The Group	
	2022 £m	2021 £m
At 1 January	**325**	325
Adjustment on transfer of subsidiary	**127**	–
At 31 December	**452**	325
Cost	**452**	325
Accumulated impairment losses	**–**	–
At 31 December	**452**	325

During the year the Group acquired 100 per cent of the ordinary share capital of MBNA Limited from its immediate parent, Lloyds Bank plc, for a cash consideration of £1 with the remainder funded by a capital contribution from Lloyds Bank plc.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. This compares the estimated recoverable amount, being the higher of a cash-generating unit's fair value less costs to sell and its value in use, with the carrying value. When this indicates that the carrying value is not recoverable it is written down through the income statement as goodwill impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; the entire balance of £452 million has been allocated to the Bank of Scotland cash generating unit.

The recoverable amount of goodwill carried at 31 December 2022 has been based on a value in use calculation using post-tax cash flow projections covering a four-year period and based upon the Group's business plan. The main assumptions used for planning purposes relate to the current economic outlook and opinions in respect of economic growth, unemployment, property markets, interest rates and credit quality. The discount rate used in discounting the projected cash flows is 10 per cent (post-tax) and a future growth rate of 3.5 per cent, reflecting the perceived risks within those businesses. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount to fall below the balance sheet carrying value.

Note 17: Investment in subsidiary undertakings of the Company

	2022 £m	2021 £m
At 1 January	**22,588**	22,552
Capital contributions	**46**	36
At 31 December	**22,634**	22,588

Details of the subsidiaries and related undertakings are given on page 105 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. Regulated banking subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

Note 18: Other assets

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Property, plant and equipment:				
Investment properties	**3**	4	**–**	–
Premises	**373**	287	**–**	–
Equipment	**156**	244	**–**	–
Right-of-use assets (note 19)	**488**	573	**–**	–
	1,020	1,108	**–**	–
Purchased credit card relationships	**310**	–	**–**	–
Capitalised software enhancements	**232**	224	**–**	–
Settlement balances	**4**	–	**–**	–
Prepayments	**145**	107	**–**	–
Other assets	**257**	122	**–**	1
Total other assets	**1,968**	1,561	**–**	1

Note 19: Lessee disclosures

The table below sets out the movement in the Group's right-of-use assets, which are primarily in respect of premises, and are recognised within other assets (note 18).

	The Group	
	2022 £m	2021 £m
At 1 January	**573**	648
Exchange and other adjustments	**(1)**	–
Additions	**16**	17
Disposals	**(22)**	(7)
Depreciation charge for the year	**(78)**	(85)
At 31 December	**488**	573

The Group's lease liabilities are recognised within other liabilities (note 22). The maturity analysis of the Group's lease liabilities on an undiscounted basis is set out in the liquidity risk section of note 38.

The total cash outflow for leases in the year ended 31 December 2022 was £96 million (2021: £105 million). The amount recognised within interest expense in respect of lease liabilities is disclosed in note 4.

Note 20: Debt securities in issue

	The Group	
	2022 £m	2021 £m
Senior unsecured notes issued	**4,876**	4,048
Covered bonds (note 21)	**500**	1,651
Securitisation notes (note 21)	**747**	1,654
Total debt securities in issue	**6,123**	7,353

At 31 December 2022 £5,752 million (2021: £4,705 million) of debt securities in issue of the Group had a contractual residual maturity of greater than one year.

Note 21: Structured entities

The Group's interests in structured entities are consolidated. Details of the Group's interests in these structured entities are set out below for securitisations and covered bond vehicles.

Securitisation programmes

The Group's balance sheet includes loans securitised under the Group's securitisation programmes, the majority of which have been sold by Group 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 Group company, 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 and financial liabilities at fair value through profit or loss.

Covered bond programmes

Certain loans and advances to customers have been assigned to a bankruptcy remote limited liability partnership 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 partnership is 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. Notes in issue, previously reported gross of internal holdings, are presented net; comparatives have been presented on a consistent basis. The notes in issue are reported in note 20 and on the balance sheet within financial liabilities at fair value through profit or loss.

	2022		2021	
	Loans and advances securitised £m	**Externally held notes in issue £m**	Loans and advances securitised £m	Externally held notes in issue £m
Securitisation programmes				
UK residential mortgages and commercial loans	**15,402**	**550**	18,688	1,093
Credit card receivables	**9,409**	**223**	3,413	594
Total securitisation programmes (note 20)[1]	**24,811**	**773**	22,101	1,687
Covered bond programmes				
Residential mortgage-backed	**–**	**–**	2,574	1,151
Social housing loan-backed	**831**	**500**	833	500
Total covered bond programmes (note 20)	**831**	**500**	3,407	1,651
Total securitisation and covered bond programmes		**1,273**		3,338

1 Includes £26 million (2021: £33 million) of securitisation notes held at fair value through profit or loss.

Note 21: Structured entities (continued)

Cash deposits of £1,501 million (2021: £1,286 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 has certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2022 these obligations had not been triggered; the maximum exposure under these facilities was £4 million (2021: £4 million).

The Group has a covered bond programme, for which a limited liability partnership has been established to ring-fence the asset pool and guarantee the covered bonds issued by the Group. At the reporting date the Group had over-collateralised this programme as set out in the table above to meet the terms of the programme, 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 programme. 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 and financial liabilities at fair value through profit or loss, 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 or as otherwise required by the transaction documents.

Note 22: Other liabilities

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Settlement balances	**50**	58	**–**	–
Lease liabilities	**550**	627	**–**	–
Other creditors and accruals	**1,001**	944	**3**	3
Total other liabilities	**1,601**	1,629	**3**	3

The maturity analysis of the Group's lease liabilities on an undiscounted basis is set out in the liquidity risk section of note 38.

Note 23: Retirement benefit obligations

	The Group	
	2022 £m	2021 £m
Defined benefit pension schemes	**65**	112
Other post-retirement benefit schemes	**1**	1
Total defined benefit schemes	**66**	113
Defined contribution pension schemes	**87**	93
Total charge to the income statement (note 8)	**153**	206

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Amounts recognised in the balance sheet				
Retirement benefit assets	**1,513**	1,749	**1,466**	1,691
Retirement benefit obligations	**(76)**	(129)	**(76)**	(129)
Total amounts recognised in the balance sheet	**1,437**	1,620	**1,390**	1,562

The total amounts recognised in the balance sheet relate to:

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Defined benefit pension schemes	**1,451**	1,658	**1,404**	1,600
Other post-retirement benefit schemes	**(14)**	(38)	**(14)**	(38)
Total amounts recognised in the balance sheet	**1,437**	1,620	**1,390**	1,562

Note 23: Retirement benefit obligations (continued)

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 most significant one being the HBOS Final Salary Pension Scheme. At 31 December 2022, this scheme represented 95 per cent of the Group's total gross defined benefit pension assets (2021: 95 per cent). These schemes provide retirement benefits calculated as a proportion of final pensionable salary depending upon the length of pensionable service; the minimum retirement age under the rules of the schemes at 31 December 2022 is generally 55, although certain categories of member are deemed to have a protected right to retire at 50.

The Group operates both funded and unfunded pension arrangements; the 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 scheme membership along with a combination of independent and employer appointed trustees to comply with legislation and scheme rules.

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 valuations of the Group's main defined benefit pension scheme showed an aggregate ongoing funding deficit of £2.6 billion as at 31 December 2019 (a funding level of 85.2 per cent). Under the agreed recovery plan, £0.3 billion plus a further 10.65 per cent of in-year capital distributions to ordinary shareholders, up to a limit on total deficit contributions of £0.7 billion per annum, is payable until the 2019 deficit has been removed.

This scheme continues to have a funding deficit, but is in a significantly stronger financial position than at 31 December 2021, when the deficit was c.£1.5 billion. During 2022, deficit contributions of £0.8 billion were paid into these schemes and the Group expects to make a further fixed contribution of £0.3 billion in the first half of 2023, consistent with 2021 and 2022.

The Group expects to have substantially agreed the triennial valuation with the Trustee by the end of the third quarter of 2023, along with a revised contribution schedule in respect of any remaining deficit. Trustee agreement will be conditional upon prior feedback from the Pensions Regulator. The Group also expects that future contributions will become increasingly contingent in nature, such that they are only paid into the schemes if required.

The Group has also established a private limited company which holds assets to provide security for the Group's obligations to the HBOS Final Salary Pension Scheme. At 31 December 2022 it held assets of £3.6 billion in aggregate. The private limited company is consolidated fully in the Group's balance sheet. The terms of this arrangement requires the Group to maintain assets in this vehicle to agreed minimum values in order to secure obligations owed to the HBOS Final Salary Pension Scheme. The Group has satisfied this requirement during 2022.

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 2022, 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 and inflation assumptions than the IAS 19 valuations.

In a judgment in 2018, the High Court confirmed the requirement to equalise the Guaranteed Minimum Pension (GMP) benefits of men and women accruing between 1990 and 1997 from contracting out of the State Earnings Related Pension Scheme. The Group recognised a past service cost of £31 million in respect of equalisation in 2018 and, following agreement of the detailed implementation approach with the Trustee, a further £3 million was recognised in 2019. A further hearing was held during 2020 which confirmed the extent of the Trustee's obligation to revisit past transfers out of the schemes. The amount of any additional liability as a result of this judgment is still being reviewed but is not considered likely to be material.

(ii) Amounts in the financial statements

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Amount included in the balance sheet				
Present value of funded obligations	**(9,706)**	(16,614)	**(9,496)**	(16,342)
Fair value of scheme assets	**11,157**	18,272	**10,900**	17,942
Net amount recognised in the balance sheet	**1,451**	1,658	**1,404**	1,600

Note 23: Retirement benefit obligations (continued)

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Net amount recognised in the balance sheet				
At 1 January	**1,658**	576	**1,600**	507
Net defined benefit pension charge	**(65)**	(112)	**(66)**	(111)
Actuarial gains on defined benefit obligation	**6,682**	698	**6,610**	725
Return on plan assets	**(7,737)**	(15)	**(7,653)**	(30)
Employer contributions	**914**	511	**913**	511
Exchange and other adjustments	**(1)**	–	**–**	(2)
At 31 December	**1,451**	1,658	**1,404**	1,600

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Movements in the defined benefit obligation				
At 1 January	**(16,614)**	(17,624)	**(16,342)**	(17,335)
Current service cost	**(88)**	(102)	**(88)**	(102)
Interest expense	**(317)**	(250)	**(313)**	(247)
Remeasurements:				
Actuarial (losses) gains – experience	**(476)**	19	**(465)**	31
Actuarial gains (losses) – demographic assumptions	**89**	(62)	**89**	(59)
Actuarial gains – financial assumptions	**7,069**	741	**6,986**	753
Benefits paid	**637**	626	**626**	603
Past service cost	**(2)**	(7)	**(2)**	(7)
Settlements	**13**	22	**13**	22
Exchange and other adjustments	**(17)**	23	**–**	(1)
At 31 December	**(9,706)**	(16,614)	**(9,496)**	(16,342)

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Analysis of the defined benefit obligation				
Active members	**(1,246)**	(2,522)	**(1,246)**	(2,522)
Deferred members	**(3,065)**	(6,121)	**(2,992)**	(6,001)
Pensioners	**(5,030)**	(7,430)	**(4,893)**	(7,278)
Dependants	**(365)**	(541)	**(365)**	(541)
At 31 December	**(9,706)**	(16,614)	**(9,496)**	(16,342)

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Changes in the fair value of scheme assets				
At 1 January	**18,272**	18,200	**17,942**	17,842
Return on plan assets excluding amounts included in interest income	**(7,737)**	(15)	**(7,653)**	(30)
Interest income	**353**	260	**348**	257
Employer contributions	**914**	511	**913**	511
Benefits paid	**(637)**	(626)	**(626)**	(603)
Settlements	**(13)**	(22)	**(13)**	(22)
Administrative costs paid	**(11)**	(13)	**(11)**	(12)
Exchange and other adjustments	**16**	(23)	**–**	(1)
At 31 December	**11,157**	18,272	**10,900**	17,942

Note 23: Retirement benefit obligations (continued)

The expense recognised in the income statement for the year ended 31 December comprises:

	The Group	
	2022 £m	2021 £m
Current service cost	**88**	102
Net interest amount	**(36)**	(10)
Past service cost – plan amendments	**2**	7
Plan administration costs incurred during the year	**11**	13
Total defined benefit pension expense	**65**	112

(iii) Composition of scheme assets

	2022			2021		
The Group	**Quoted £m**	**Unquoted £m**	**Total £m**	Quoted £m	Unquoted £m	Total £m
Equity instruments	**2**	**16**	**18**	194	12	206
Debt instruments[1]:						
Fixed interest government bonds	**1,413**	**–**	**1,413**	5,971	–	5,971
Index-linked government bonds	**6,220**	**–**	**6,220**	8,443	–	8,443
Corporate and other debt securities	**1,261**	**–**	**1,261**	4,748	–	4,748
	8,894	**–**	**8,894**	19,162	–	19,162
Property	**–**	**116**	**116**	–	139	139
Pooled investment vehicles	**2,348**	**2,887**	**5,235**	359	3,994	4,353
Money market instruments, cash, derivatives and other assets and liabilities	**659**	**(3,765)**	**(3,106)**	460	(6,048)	(5,588)
At 31 December	**11,903**	**(746)**	**11,157**	20,175	(1,903)	18,272

1 Of the total debt instruments, £8,226 million (2021: £17,211 million) were investment grade (credit ratings equal to or better than 'BBB').

	2022			2021		
The Company	**Quoted £m**	**Unquoted £m**	**Total £m**	Quoted £m	Unquoted £m	Total £m
Equity instruments	**2**	**16**	**18**	194	12	206
Debt instruments[1]:						
Fixed interest government bonds	**1,403**	**–**	**1,403**	5,950	–	5,950
Index-linked government bonds	**6,220**	**–**	**6,220**	8,443	–	8,443
Corporate and other debt securities	**1,177**	**–**	**1,177**	4,676	–	4,676
	8,800	**–**	**8,800**	19,069	–	19,069
Property	**–**	**116**	**116**	–	–	–
Pooled investment vehicles	**2,348**	**2,712**	**5,060**	359	3,815	4,174
Money market instruments, cash, derivatives and other assets and liabilities	**659**	**(3,753)**	**(3,094)**	460	(5,967)	(5,507)
At 31 December	**11,809**	**(909)**	**10,900**	20,082	(2,140)	17,942

1 Of the total debt instruments, £8,134 million (2021: £17,119 million) were investment grade (credit ratings equal to or better than 'BBB').

The assets of all of the funded plans are held independently of the Group's assets in separate trustee-administered funds.

Note 23: Retirement benefit obligations (continued)

The pension schemes' pooled investment vehicles comprise:

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Equity funds	**399**	897	**399**	897
Hedge and mutual funds	**79**	473	**79**	473
Alternative credit funds	**726**	1,331	**645**	1,231
Property funds	**396**	329	**396**	329
Infrastructure funds	**721**	744	**721**	744
Liquidity funds	**2,854**	494	**2,793**	446
Bond and debt funds	**26**	54	**26**	54
Other	**34**	31	**1**	–
At 31 December	**5,235**	4,353	**5,060**	4,174

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.

Climate change is one of the risks the schemes manage given its potential financial impact on valuation of assets.

(iv) Assumptions

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

	2022 %	2021 %
Discount rate	**4.93**	1.94
Rate of inflation:		
Retail Price Index (RPI)	**2.99**	3.21
Consumer Price Index (CPI)	**2.68**	2.92
Rate of salary increases	**0.00**	0.00
Weighted-average rate of increase for pensions in payment	**3.01**	3.05

On 25 November 2020 the Chancellor of the Exchequer announced the outcome of a consultation into a reform of the calculation of RPI. It is now expected that from 2030 RPI will be aligned with CPIH (the Consumer Price Index including owner occupiers' housing costs). To determine the RPI assumption a term-dependent inflation curve has been used adjusting for an assumed inflation risk premium. In the period to 2030 a gap of 100 basis points has been assumed between RPI and CPI; thereafter a 10 basis point gap has been assumed.

	Men		Women	
	2022 Years	2021 Years	**2022 Years**	2021 Years
Life expectancy for member aged 60, on the valuation date	**26.7**	27.1	**28.8**	29.1
Life expectancy for member aged 60, 15 years after the valuation date	**27.8**	28.1	**30.0**	30.3

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 2022 is assumed to live for, on average, 26.7 years for a male and 28.8 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. The Group uses the CMI mortality projections model and in line with actuarial industry recommendations has placed no weight on 2020 and 2021 mortality experience. The persistence of excess deaths during 2022 has highlighted the potential longer term impacts of COVID-19 and the Group has applied a 4 per cent scaling factor to its base mortality tables at December 2022 to allow for this impact on member mortality. This led to a c.1 per cent reduction in the defined benefit obligation.

Note 23: Retirement benefit obligations (continued)

(v) Amount, timing and uncertainty of future cash flows

Risk exposure of the defined benefit schemes

While 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.

In addition, the schemes themselves are exposed to liquidity risk with the need to ensure that liquid assets held are sufficient to meet benefit payments as they fall due and there is sufficient collateral available to support their hedging activity.

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 material schemes, is set out below. The sensitivities provided assume that all other assumptions and the value of the schemes' assets remain unchanged, and are not intended to represent changes that are at the extremes of possibility. The calculations are approximate in nature and full detailed calculations could lead to a different result. It is unlikely that isolated changes to individual assumptions will be experienced in practice. Due to the correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of simultaneous changes in multiple assumptions.

	Effect of reasonably possible alternative assumptions on material schemes							
	The Group				The Company			
	Increase (decrease) in the income statement charge		(Increase) decrease in the net defined benefit pension scheme surplus		Increase (decrease) in the income statement charge		(Increase) decrease in the net defined benefit pension scheme surplus	
The Group	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m	**2022 £m**	2021 £m
Inflation (including pension increases)[1]:								
Increase of 0.1 per cent	**5**	5	**84**	172	**5**	5	**84**	172
Decrease of 0.1 per cent	**(5)**	(5)	**(87)**	(169)	**(5)**	(5)	**(87)**	(169)
Discount rate[2]:								
Increase of 0.1 per cent	**(10)**	(10)	**(141)**	(295)	**(10)**	(10)	**(141)**	(295)
Decrease of 0.1 per cent	**10**	9	**145**	303	**10**	9	**145**	303
Expected life expectancy of members:								
Increase of one year	**13**	17	**240**	680	**13**	17	**240**	680
Decrease of one year	**(13)**	(16)	**(245)**	(652)	**(13)**	(16)	**(245)**	(652)

1 At 31 December 2022, the assumed rate of RPI inflation is 2.99 per cent and CPI inflation 2.68 per cent (2021: RPI 3.21 per cent and CPI 2.92 per cent).

2 At 31 December 2022, the assumed discount rate is 4.93 per cent (2021: 1.94 per cent).

Sensitivity analysis method and assumptions

The sensitivity analysis above reflects the impact on the liabilities of the Group's most material schemes. While 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 the assumed rate of increase in both the Consumer Price Index (CPI) and the Retail Price Index (RPI), and includes 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. While 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.

Note 23: Retirement benefit obligations (continued)

Asset-liability matching strategies

The main schemes' assets are invested in a diversified portfolio. Whilst c.50 per cent are held to generate the long-term returns required to support the funding position of the schemes, the remainder is invested in liability-driven investment (LDI) strategies which hedge the material risk exposures of the schemes. The investment strategy is not static and will evolve to reflect the structure of liabilities within the schemes. Specific 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 strategies adopted by the 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. The assets in these LDI strategies represented 51 per cent of scheme assets at 31 December 2022.

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. At 31 December 2022 the asset-liability matching strategy mitigated around 120 per cent of the liability sensitivity to interest rate movements and around 137 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. The higher level of hedging provides greater protection to the funding position of the schemes.

The schemes' funding position remained robust and did not experience any material impact from the market volatility seen in the latter part of last year. Asset prices fell in line with the broader market and hedges fell in value as interest rates rose, and a similar impact was experienced on liability valuations which also fell in value given the portfolio was almost fully hedged. The Group's schemes use LDI strategies to achieve this outcome and, as the hedging was maintained throughout the crisis, the strategy performed as expected. All collateral requirements in respect of the LDI strategies were met, with no support required from the Group beyond payment of scheduled contributions.

On 28 January 2020, the main scheme entered into a £3 billion longevity insurance arrangement to hedge part of the scheme's exposure to unexpected increases in life expectancy. This arrangement forms part of the scheme's investment portfolio and will provide income to the scheme in the event that pensions are paid out for longer than expected. The transaction was structured as a pass-through with Scottish Widows as the insurer, and onwards reinsurance to Pacific Life Re Limited.

At 31 December 2022 the value of scheme assets included £(20) million representing the value of the longevity swaps (after allowing for the impact on the IAS 19 liabilities of the revisions to the base mortality assumptions).

In total the schemes have now hedged around 19 per cent of their longevity risk exposure.

Maturity profile of defined benefit obligation

The following table provides information on the weighted average duration of the defined benefit pension obligation and the distribution and timing of benefit payments:

	The Group		The Company	
	2022 Years	2021 Years	**2022 Years**	2021 Years
Duration of the defined benefit obligation	**16**	19	**16**	19

Maturity analysis of benefits expected to be paid:

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Within 12 months	**386**	386	**378**	379
Between 1 and 2 years	**411**	406	**403**	400
Between 2 and 5 years	**1,355**	1,360	**1,330**	1,339
Between 5 and 10 years	**2,726**	2,751	**2,679**	2,710
Between 10 and 15 years	**3,121**	3,245	**3,067**	3,198
Between 15 and 25 years	**6,274**	6,657	**6,155**	6,555
Between 25 and 35 years	**5,045**	5,497	**4,954**	5,416
Between 35 and 45 years	**2,845**	3,239	**2,797**	3,195
In more than 45 years	**986**	1,229	**970**	1,214

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.

During the year ended 31 December 2022 the charge to the income statement in respect of defined contribution schemes was £87 million (2021: £93 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Note 23: Retirement benefit obligations (continued)

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.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2022 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 6.74 per cent (2021: 6.82 per cent).

Movements in the other post-retirement benefits obligation:

	The Group and Company	
	2022 £m	2021 £m
At 1 January	**(38)**	(41)
Actuarial gains (losses)	**24**	3
Insurance premiums paid	**1**	1
Charge for the year	**(1)**	(1)
At 31 December	**(14)**	(38)

Note 24: Deferred tax

The Group's and the Company's deferred tax assets and liabilities are as follows:

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Statutory position				
Deferred tax assets	**1,501**	1,502	**–**	–
Deferred tax liabilities	**–**	–	**(348)**	(390)
Net deferred tax asset (liability) at 31 December	**1,501**	1,502	**(348)**	(390)
Tax disclosure				
Deferred tax assets	**2,080**	2,114	**19**	34
Deferred tax liabilities	**(579)**	(612)	**(367)**	(424)
Net deferred tax asset (liability) at 31 December	**1,501**	1,502	**(348)**	(390)

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 and the Company 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.

Movements in deferred tax assets and liabilities (before taking into consideration the offsetting of balances within the same taxing jurisdiction) can be summarised as follows:

The Group Deferred tax assets	**Tax losses £m**	**Property, plant and equipment £m**	**Provisions £m**	**Share-based payments £m**	**Pension liabilities £m**	**Derivatives £m**	**Other temporary differences £m**	**Total £m**
At 1 January 2021	1,547	103	88	6	27	17	25	1,813
Credit (charge) to the income statement	280	–	2	(2)	8	–	4	292
Credit (charge) to other comprehensive income	–	–	–	–	(2)	11	–	9
At 31 December 2021	1,827	103	90	4	33	28	29	2,114
Credit (charge) to the income statement	**26**	**(27)**	**(14)**	**–**	**(16)**	**(7)**	**(23)**	**(61)**
Credit to other comprehensive income	**–**	**–**	**–**	**–**	**–**	**5**	**–**	**5**
Acquisition	**–**	**2**	**19**	**–**	**–**	**–**	**1**	**22**
At 31 December 2022	**1,853**	**78**	**95**	**4**	**17**	**26**	**7**	**2,080**

Note 24: Deferred tax (continued)

The Group Deferred tax liabilities	Capitalised software enhancements £m	Acquisition fair value £m	Pension assets £m	Asset revaluations[1] £m	Other temporary differences £m	Total £m
At 1 January 2021	(16)	–	(134)	(6)	(75)	(231)
Charge to the income statement	(4)	–	(84)	(13)	(67)	(168)
(Charge) credit to other comprehensive income	–	–	(224)	12	–	(212)
Exchange and other adjustments	–	–	–	–	(1)	(1)
At 31 December 2021	(20)	–	(442)	(7)	(143)	(612)
Credit to the income statement	**8**	**4**	**21**	**7**	**22**	**62**
Credit to other comprehensive income	**–**	**–**	**51**	**–**	**–**	**51**
Acquisition	**–**	**(80)**	**–**	**–**	**–**	**(80)**
At 31 December 2022	**(12)**	**(76)**	**(370)**	**–**	**(121)**	**(579)**

1 Financial assets at fair value through other comprehensive income.

The Company Deferred tax assets	Provisions £m	Pension liabilities £m	Total £m
At 1 January 2021	38	27	65
Credit (charge) to the income statement	(38)	9	(29)
Charge to other comprehensive income	–	(2)	(2)
At 31 December 2021	–	34	34
Charge to the income statement	**–**	**(15)**	**(15)**
At 31 December 2022	**–**	**19**	**19**

The Company Deferred tax liabilities	Pension assets £m	Other temporary differences £m	Total £m
At 1 January 2021	(115)	–	(115)
Charge to the income statement	(84)	(1)	(85)
Charge to other comprehensive income	(224)	–	(224)
At 31 December 2021	(423)	(1)	(424)
Credit to the income statement	**12**	**1**	**13**
Credit to other comprehensive income	**44**	**–**	**44**
At 31 December 2022	**(367)**	**–**	**(367)**

1 Financial assets at fair value through other comprehensive income.

At 31 December 2022 the Group carried net deferred tax assets on its balance sheet of £1,501 million (2021: £1,502 million) and the Company carried deferred tax liabilities of £348 million (2021: £390 million) principally relating to pension assets.

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent that 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 £1,853 million (2021: £1,827 million), in respect of trading losses carried forward. Substantially all of these losses have arisen in Bank of Scotland plc and they will be utilised as taxable profits arise in this legal entity in future periods.

The Group's expectations of future UK taxable profits require management judgement, and 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, climate-related and other change, in order to produce a base case forecast of future UK taxable profits. Under current law there is no expiry date for UK trading losses not yet utilised, and given the forecast of future profitability and the Group's commitment to the UK market, in management's judgement it is more likely than not that the value of the losses will be recovered by the Group while still operating as a going concern. Banking tax 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. These restrictions in utilisation mean that the value of the deferred tax asset in respect of tax losses is only expected to be fully recovered by 2032 (2021: 2034) in the base case forecast. It is possible that future tax law changes could materially affect the timing of recovery and the value of these losses ultimately realised by the Group.

Deferred tax not recognised

Deferred tax assets of £29 million (2021: £31 million) for the Group have not been recognised in respect of £116 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.

No deferred tax has been recognised in respect of foreign trade losses of £37 million (2021: £34 million) for the Group which will expire if not used within 20 years, and £2 million (2021: £2 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.

Note 25: Other provisions

The Group	Provisions for financial commitments and guarantees £m	Regulatory and legal provisions £m	Other £m	Total £m
At 1 January 2022	56	835	166	1,057
Exchange and other adjustments[1]	–	175	21	196
Acquisition of business[2]	29	–	–	29
Provisions applied	–	(392)	(94)	(486)
Net charge for the year[3]	30	91	56	177
At 31 December 2022	115	709	149	973

1 Includes increases in regulatory and legal provisions covered by insurance claims.
2 On 30 November 2022 the Group acquired MBNA Limited, formerly a subsidiary of Lloyds Bank plc, a fellow Lloyds Banking Group undertaking.
3 The charge for regulatory and legal provisions is presented net of £79 million insurance claims receivable.

Provisions for financial commitments and guarantees

Provisions are recognised for expected credit losses on undrawn loan commitments and financial guarantees. See also note 13.

Regulatory and legal provisions

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 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 2022 the Group charged a further £91 million in respect of legal actions and other regulatory matters and the unutilised balance at 31 December 2022 was £709 million (31 December 2021: £835 million). The most significant items are as follows.

HBOS Reading – review

The Group continues to apply the recommendations from Sir Ross Cranston’s review, issued in December 2019, including a reassessment of direct and consequential losses by an independent panel (the Foskett Panel), an extension of debt relief and a wider definition of de facto directors. The Foskett Panel's full scope and methodology was published on 7 July 2020. The Foskett Panel’s stated objective is to consider cases via a non-legalistic and fair process and to make their decisions in a generous, fair and common sense manner, assessing claims against an expanded definition of the fraud and on a lower evidential basis.

Following the emergence of the first outcomes of the Foskett Panel through 2021, the Group charged a further £790 million in the year ended 31 December 2021. This included operational costs in relation to Dame Linda Dobbs's review, which is considering whether the issues relating to HBOS Reading were investigated and appropriately reported by the Group during the period from January 2009 to January 2017, and other programme costs. A significant proportion of the charge related to the estimated future awards from the Foskett Panel. The Foskett Panel had shared outcomes on a limited subset of the total population which covers a wide range of businesses and different claim characteristics. The estimated awards provision recognised at 31 December 2021 was therefore materially dependent on the assumption that the limited number of awards to date were representative of the full population of cases.

In June 2022, the Foskett Panel announced an alternative option, in the form of a fixed sum award which could be accepted as an alternative to participation in the full re-review process, to support earlier resolution of claims for those deemed by the Foskett Panel to be victims of the fraud. Around half the population have now had outcomes via this new process. Extrapolating the Group’s experience to date resulted in an increase to the provision of £50 million in the year (all in the fourth quarter). Notwithstanding the settled claims and the increase in coverage which builds confidence in the full estimated cost, uncertainties remain and the final outcome could be different from the current provision once the re-review is concluded by the Foskett Panel. There is no confirmed timeline for the completion of the Foskett Panel re-review process nor the review by Dame Linda Dobbs. The Group is committed to implementing Sir Ross's recommendations in full.

Payment protection insurance

The Group has incurred costs for PPI over a number of years totalling £6,356 million. The Group continues to challenge PPI litigation cases, with mainly legal fees and operational costs associated with litigation activity recognised within regulatory and legal provisions, including a charge in the fourth quarter. PPI litigation remains inherently uncertain, with a number of key court judgments due to be delivered in 2023.

Note 26: Subordinated liabilities

The movement in subordinated liabilities during the year was as follows:

	The Group				The Company			
	Preferred securities £m	Undated £m	Dated £m	Total £m	Preferred securities £m	Undated £m	Dated £m	Total £m
At 1 January 2021	183	155	2,515	2,853	113	11	1,380	1,504
Issued during the year[1]:								
Subordinated Floating Rate Note (24 September 2026) (£500 million)	–	–	500	500	–	–	–	–
Repurchases and redemptions during the year[1]:								
7.754% Non-cumulative Perpetual Preferred Securities (Class B) (£150 million)	(156)	–	–	(156)	–	–	–	–
Floating Rate Primary Capital Notes (US$250 million)	–	(24)	–	(24)	–	–	–	–
9.375% Subordinated Bonds 2021 (£500 million)	–	–	(200)	(200)	–	–	–	–
5.374% Subordinated Fixed Rate Notes 2021 (€160 million)	–	–	(145)	(145)	–	–	(145)	(145)
6% Subordinated Notes 2033 (US$750 million)	–	–	(178)	(178)	–	–	(124)	(124)
	(156)	(24)	(523)	(703)	–	–	(269)	(269)
Foreign exchange movements	–	1	(40)	(39)	–	–	(42)	(42)
Other movements (cash and non-cash)[2]	8	(2)	(55)	(49)	37	1	(23)	15
At 31 December 2021	35	130	2,397	2,562	150	12	1,046	1,208
Repurchases and redemptions during the year[1]:								
7.281% Perpetual Regulatory Tier One Securities (Series B) (£150 million)	**(22)**	**–**	**–**	**(22)**	**–**	**–**	**–**	**–**
7.881% Guaranteed Non-voting Non-cumulative Preferred Securities (£245 million)	**(12)**	**–**	**–**	**(12)**	**–**	**–**	**–**	**–**
12% Perpetual Subordinated Bonds (£100 million)	**–**	**(22)**	**–**	**(22)**	**–**	**–**	**–**	**–**
5.75% Undated Subordinated Step-up Notes (£600 million)	**–**	**(4)**	**–**	**(4)**	**–**	**(4)**	**–**	**(4)**
7.881% Subordinated Notes 2048 (£245 million)	**–**	**–**	**–**	**–**	**–**	**–**	**(384)**	**(384)**
	(34)	**(26)**	**–**	**(60)**	**–**	**(4)**	**(384)**	**(388)**
Foreign exchange movements	**–**	**–**	**67**	**67**	**–**	**–**	**56**	**56**
Other movements (cash and non-cash)[2]	**(1)**	**–**	**(112)**	**(113)**	**(150)**	**–**	**93**	**(57)**
At 31 December 2022	**–**	**104**	**2,352**	**2,456**	**–**	**8**	**811**	**819**

1 Issuances in 2021 generated cash inflows for the Group of £500 million and £nil for the Company (2022: £nil for the Group and the Company); the repurchases and redemptions in the year resulted in cash outflows of £60 million for the Group and £16 million for the Company (2021: £696 million for the Group and £316 million for the Company)

2 Other movements include cash payments in respect of interest on subordinated liabilities in the year amounted to £101 million for the Group and £43 million for the Company (2021: £84 million for the Group and £69 million for the Company) offset by the interest expense in respect of subordinated liabilities of £100 million for the Group and £43 million for the Company (2021: £105 million for the Group and £73 million for the Company).

Certain of the above securities were issued or redeemed under exchange offers, which did not result in an extinguishment of the original financial liability for accounting purposes.

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. Neither the Group nor the Company has had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2022 (2021: none).

The Company has in issue preference shares which are all classified as liabilities under accounting standards. The rights and obligations attaching to these shares are set out in the Company's articles of association, a copy of which can be obtained from Companies House.

Note 27: Share capital

(1) Authorised share capital

As permitted by the Companies Act 2006, the Company has removed references to authorised share capital from its articles of association.

(2) Issued and fully paid share capital

	The Group and the Company			
	2022 Number of shares	2021 Number of shares	**2022 £m**	2021 £m
Issued and fully paid ordinary shares				
Ordinary shares of 25p each				
At 1 January	**15,053,262,841**	15,053,262,841	**3,763**	3,763
Issued in the year	**60,000,000**	–	**15**	–
At 31 December	**15,113,262,841**	15,053,262,841	**3,778**	3,763
Issued and fully paid preference shares				
Preferences shares of £1 each				
At 1 January and 31 December	**100**	100	**–**	–
Total share capital at 31 December			**3,778**	3,763

(3) Share capital and control

There are no limitations on voting rights or 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).

Ordinary shares

The holders of ordinary shares 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.

Issued and fully paid preference shares

The Company has in issue preference shares which are all classified as liabilities under accounting standards and which are included in note 26.

Note 28: Share premium account

	The Group and the Company	
	2022 £m	2021 £m
At 1 January	**–**	–
Issued in the year	**585**	–
At 31 December	**585**	–

Note 29: Other reserves

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Merger reserve and other reserves[1]	**10,051**	10,051	**9,537**	9,537
Capital redemption reserve[1]	**141**	141	**141**	141
Capital contribution reserve	**1,054**	–	**–**	–
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**14**	58	**–**	–
Cash flow hedging reserve	**(65)**	(63)	**–**	–
Foreign currency translation reserve	**(22)**	(22)	**–**	–
At 31 December	**11,173**	10,165	**9,678**	9,678

1 There have been no movements in these reserves in 2022 or 2021.

Movements in other reserves were as follows:

	The Group	
Capital contribution reserve	**2022 £m**	2021 £m
At 1 January	**–**	–
Capital contribution received (note 33)	**1,054**	–
At 31 December	**1,054**	–

This reserve comprises non-distributable capital contributions received by the Group.

	The Group	
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**2022 £m**	2021 £m
At 1 January	**58**	48
Change in fair value	**(73)**	(2)
Deferred tax	**11**	(1)
Current tax	**7**	–
	(55)	(3)
Income statement transfers in respect of disposals (note 7)	**15**	–
Deferred tax	**(4)**	13
	11	13
At 31 December	**14**	58

	The Group	
Cash flow hedging reserve	**2022 £m**	2021 £m
At 1 January	**(63)**	(45)
Change in fair value of hedging derivatives	**11**	(48)
Deferred tax	**(5)**	16
	6	(32)
Net income statement transfers	**(11)**	19
Deferred tax	**3**	(5)
	(8)	14
At 31 December	**(65)**	(63)

	The Group	
Foreign currency translation reserve	**2022 £m**	2021 £m
At 1 January	**(22)**	(23)
Currency translation differences arising in the year	**–**	1
At 31 December	**(22)**	(22)

Note 30: Retained profits

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
At 1 January	**(562)**	(2,292)	**10,436**	9,204
Profit attributable to ordinary shareholders[1]	**1,018**	1,734	**32**	1,224
Post-retirement defined benefit scheme remeasurements	**(820)**	460	**(815)**	472
Dividends paid (note 31)	**–**	(500)	**–**	(500)
Capital contributions received	**46**	36	**46**	36
Adjustment on transfer of subsidiary	**(19)**	–	**–**	–
At 31 December	**(337)**	(562)	**9,699**	10,436

1 No income statement has been shown for the Company, as permitted by Section 408 of the Companies Act 2006.

Note 31: Dividends on ordinary shares

Dividends paid during the year were as follows:

	2022 £m	2021 £m
Interim dividends	**–**	500

Note 32: Share-based payments

During the year ended 31 December 2022 Lloyds Banking Group plc operated a number of share-based payment schemes for which employees of the HBOS Group were eligible and all of which are equity settled. Details of all schemes operated by Lloyds Banking Group are set out below; these are managed and operated on a Lloyds Banking Group-wide basis. The amount charged to the Group's income statement in respect of Lloyds Banking Group share-based payment schemes, and which is included within staff costs (note 8), was £72 million (2021: £45 million).

During the year ended 31 December 2022 the Lloyds Banking Group operated the following share-based payment schemes, all of which are mainly equity settled.

Lloyds Banking Group Performance Share plan

The Lloyds Banking Group operates a Group Performance Share plan that is part equity settled. Bonuses in respect of employee service in 2022 have been recognised in the charge in line with the proportion of the deferral period completed.

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 Lloyds Banking Group at a discounted price of no less than 90 per cent of the market price at the start of the invitation period.

Movements in the number of share options outstanding under the SAYE schemes are set out below:

	2022		2021	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**1,180,563,291**	**30.63**	1,120,138,915	30.39
Granted	**217,611,519**	**39.38**	236,923,744	39.40
Exercised	**(23,359,526)**	**37.75**	(6,924,434)	30.57
Forfeited	**(20,961,259)**	**29.20**	(22,815,078)	28.78
Cancelled	**(47,687,607)**	**33.88**	(51,479,310)	32.57
Expired	**(49,248,343)**	**46.29**	(95,280,546)	49.03
Outstanding at 31 December	**1,256,918,075**	**31.30**	1,180,563,291	30.63
Exercisable at 31 December	**263,302**	**47.92**	336,561	51.03

The weighted average share price at the time that the options were exercised during 2022 was £0.49 (2021: £0.47). The weighted average remaining contractual life of options outstanding at the end of the year was 1.88 years (2021: 2.46 years).

The weighted average fair value of SAYE options granted during 2022 was £0.07 (2021: £0.09). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

Note 32: Share-based payments (continued)

Other share option plans

Executive Share Plans - buyout and retention awards

Share options may be granted to senior employees under the Lloyds Banking Group Executive Share Plan 2003, Lloyds Banking Group Executive Group Ownership Share Plan and the Deferred Bonus Scheme 2021 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.

	2022		2021	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**14,032,762**	**Nil**	8,477,084	Nil
Granted	**10,278,224**	**Nil**	13,610,204	Nil
Exercised	**(3,333,322)**	**Nil**	(7,110,663)	Nil
Vested	**–**	**Nil**	–	Nil
Forfeited	**(33,409)**	**Nil**	(385,184)	Nil
Lapsed	**(477,784)**	**Nil**	(558,679)	Nil
Outstanding at 31 December	**20,466,471**	**Nil**	14,032,762	Nil
Exercisable at 31 December	**1,638,202**	**Nil**	708,939	Nil

The weighted average fair value of options granted in the year was £0.44 (2021: £0.42). 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 2022 was £0.46 (2021: £0.43). The weighted average remaining contractual life of options outstanding at the end of the year was 6.0 years (2021: 6.3 years).

Included in the above are awards to the Chief Financial Officer and the Group Chief Executive.

William Chalmers joined the Group on 3 June 2019 and was appointed as Chief Financial Officer on 1 August 2019. 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.

	2022 Number of shares	2021 Number of shares
Outstanding at 1 January	**686,085**	1,810,712
Exercised	**(686,085)**	(1,124,627)
Outstanding at 31 December	**–**	686,085

Charlie Nunn joined the Group on 16 August 2021 as Group Chief Executive. He was granted deferred share awards over 8,301,708 shares to replace unvested awards from his former employer, HSBC, that were forfeited as a result of him joining the Group.

	2022 Number of shares	2021 Number of shares
Outstanding at 1 January	**7,444,787**	–
Granted	**–**	8,301,708
Exercised	**(859,340)**	(856,921)
Outstanding at 31 December	**6,585,447**	7,444,787

The weighted average fair value of awards granted in 2021 was £0.40.

Other share plans

Lloyds Banking Group Executive Group Ownership Share 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 Lloyds Banking 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 2019 grant, the targets had not been fully met and therefore these awards vested in 2022 at a rate of 41.80 per cent.

	2022 Number of shares	2021 Number of shares
Outstanding at 1 January	**350,873,627**	533,987,527
Granted	**–**	–
Vested	**(50,703,778)**	(39,621,415)
Forfeited	**(98,741,356)**	(144,437,243)
Dividend award	**966,016**	944,758
Outstanding at 31 December	**202,394,509**	350,873,627

Note 32: Share-based payments (continued)

Awards in respect of the 2020 grant are due to vest in 2023 at a rate of 43.70 per cent. In previous years participants were entitled to any dividends paid in the vesting period. However, following a regulatory change prohibiting the payment of dividends on such awards, the number of shares awarded has been determined by applying a discount factor to the share price on award to exclude the value of estimated future dividends.

Lloyds Banking Group Long Term Share Plan

The plan, introduced in 2021, replaced the Lloyds Banking Group Executive Group Ownership Share Plan and is intended to provide alignment to the Group's aim of delivering sustainable returns to shareholders, supported by its values and behaviours.

	2022 Number of shares	2021 Number of shares
Outstanding at 1 January	**77,883,068**	–
Granted	**108,513,202**	83,456,304
Vested	**–**	–
Forfeited	**(14,448,527)**	(5,573,236)
Dividend award	**–**	–
Outstanding at 31 December	**171,947,743**	77,883,068

The weighted average fair value of awards granted in the year was £0.36 (2021: £0.36).

Assumptions at 31 December 2022

The fair value calculations at 31 December 2022 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	SAYE	**Executive Share Plans**	**Long Term Share Plan**
Weighted average risk-free interest rate	**4.33%**	**3.20%**	**1.01%**
Weighted average expected life	**3.3 years**	**1.2 years**	**3.6 years**
Weighted average expected volatility	**28%**	**27%**	**33%**
Weighted average expected dividend yield	**5.3%**	**5.3%**	**5.3%**
Weighted average share price	**£0.42**	**£0.47**	**£0.43**
Weighted average exercise price	**£0.39**	**Nil**	**Nil**

Expected volatility is a measure of the amount by which the Lloyds Banking 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 Lloyds Banking Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Share Incentive Plans

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 Lloyds Banking Group within this three-year period for other than a 'good' reason, all of the shares awarded will be forfeited.

No award was made in 2022.

On 25 March 2021, the Lloyds Banking Group made an award of 1,017 shares to all eligible employees. The number of shares awarded was 67,658,976, with an average fair value of £0.42 based on the market price at the date of award.

Matching shares

The Lloyds Banking 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.

The number of shares awarded relating to matching shares in 2022 was 43,378,504 (2021: 46,621,026), with an average fair value of £0.45 (2021: £0.44), 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 plc shares, and were initially released over five years with 20 per cent being released each year following the year of award. From June 2020, the fixed share awards are released over three years with one third being released each year following the year of award. The number of shares purchased in relation to fixed share awards in 2022 was 7,261,080 (2021: 8,320,948) with an average fair value of £0.47 (2021: £0.45) based on market prices at the date of the award.

The fixed share award is not subject to any performance conditions, performance adjustment or clawback. On an employee leaving the Lloyds Banking Group, there is no change to the timeline for which shares will become unrestricted.

Note 33: 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:

	2022 £m	2021 £m
Compensation		
Salaries and other short-term benefits	**6**	5
Share-based payments	**7**	7
Total compensation	**13**	12

The aggregate of the emoluments of the directors was £4.6 million (2021: £5.3 million).

Aggregate company contributions in respect of key management personnel to defined contribution pension schemes were £nil (2021: £nil).

The total for the highest paid director (Charlie Nunn) was £2,580,000 (2021: Sir António Horta-Osório: £1,559,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in any year.

	2022 million	2021 million
Share plans settled in Lloyds Banking Group plc shares		
At 1 January	**74**	117
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	**29**	19
Exercised/lapsed (includes entitlements of former key management personnel)	**(31)**	(62)
At 31 December	**72**	74

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:

	2022 £m	2021 £m
Loans		
At 1 January	**3**	2
Advanced (includes loans to appointed key management personnel)	**1**	1
Repayments (includes loans to former key management personnel)	**(2)**	–
At 31 December	**2**	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 1.01 per cent and 30.15 per cent in 2022 (2021: 0.39 per cent and 22.93 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2021: £nil).

	2022 £m	2021 £m
Deposits		
At 1 January	**11**	11
Placed (includes deposits of appointed key management personnel)	**37**	26
Withdrawn (includes deposits of former key management personnel)	**(38)**	(26)
At 31 December	**10**	11

Deposits placed by key management personnel attracted interest rates of up to 5.0 per cent (2021: 1.0 per cent).

At 31 December 2022, the Group did not provide any guarantees in respect of key management personnel (2021: none).

At 31 December 2022, transactions, arrangements and agreements entered into by the Lloyds Banking Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2.1 thousand with three directors and no connected persons (2021: £0.6 million with five directors and two connected persons).

Note 33: Related party transactions (continued)

Balances and transactions with fellow Lloyds Banking Group undertakings

Balances and transactions between members of the HBOS Group

In accordance with IFRS 10 *Consolidated Financial Statements*, transactions and balances between the Company and its subsidiary undertakings, and between those subsidiary undertakings, have all been eliminated on consolidation and thus are not reported as related party transactions of the Group.

The Company, as a result of its position as parent of a banking group, has a large number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Company as follows:

	2022 £m	2021 £m
Assets, included within:		
Derivative financial instruments	**27**	163
Financial assets at fair value through profit or loss	**–**	384
Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings	**3,209**	2,655
Liabilities, included within:		
Due to fellow Lloyds Banking Group undertakings	**2,502**	1,879
Derivative financial instruments	**–**	80
Subordinated liabilities	**–**	246

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2022 the Company earned interest income on the above asset balances of £142 million (2021: £170 million) and incurred interest expense on the above liability balances of £69 million (2021: £78 million).

Balances and transactions with Lloyds Banking Group plc and fellow subsidiaries of the Lloyds Banking Group

The Company and its subsidiaries have balances due to and from the Company's ultimate parent company, Lloyds Banking Group plc and fellow subsidiaries of the Lloyds Banking Group. These are included on the balance sheet as follows:

	The Group	
	2022 £m	2021 £m
Assets, included within:		
Derivative financial instruments	**2,901**	2,331
Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings	**13,982**	15,181
Liabilities, included within:		
Due to fellow Lloyds Banking Group undertakings	**88,180**	74,789
Derivative financial instruments	**4,063**	3,469
Debt securities in issue	**4,196**	3,387
Subordinated liabilities	**1,564**	1,565

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2022 the Group earned £258 million and the Company earned £nil interest income on the above asset balances (2021: Group £58 million, Company £nil); the Group incurred £2,615 million and the Company incurred £nil interest expense on the above liability balances (2021: Group £1,466 million, Bank £nil).

During the year the Company's subsidiary, Bank of Scotland plc, acquired 100 per cent of the ordinary share capital of MBNA Limited from the Company's immediate parent, Lloyds Bank plc, for a cash consideration of £1 with the remainder funded by a capital contribution of £1,229 million from Lloyds Bank plc.

Other related party transactions

Pension funds

At 31 December 2022, customer deposits of £33 million (2021: £144 million) related to the HBOS Group's pension funds.

Joint ventures and associates

At 31 December 2022 there were loans and advances to customers of £17 million (2021: £14 million) outstanding and balances within customer deposits of £6 million (2021: £4 million) relating to joint ventures and associates.

Note 34: Contingent liabilities, commitments and guarantees

Interchange fees

With respect to multi-lateral interchange fees (MIFs), the Lloyds Banking Group is not a party in the ongoing or threatened litigation which involves the card schemes Visa and Mastercard (as described below). 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 or on behalf of retailers against both Visa and Mastercard in the English Courts, in which retailers are seeking damages on grounds that Visa and Mastercard's MIFs breached competition law (this includes a judgment of the Supreme Court in June 2020 upholding the Court of Appeal's finding in 2018 that certain historic interchange arrangements of Mastercard and Visa infringed competition law)
- 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, such that it is not practicable for the Group to provide an estimate of any potential financial effect. 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 Lloyds Banking 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 Lloyds Banking Group may be subject and this cap is set at the cash consideration received by the Lloyds Banking Group for the sale of its stake in Visa Europe to Visa Inc in 2016. In 2016, the Lloyds Banking Group received Visa preference shares as part of the consideration for the sale of its shares in Visa Europe. In 2020, some of these Visa preference shares were converted into Visa Inc Class A common stock (in accordance with the provisions of the Visa Europe sale documentation) and they were subsequently sold by the Lloyds Banking Group. The sale has no impact on this contingent liability.

LIBOR and other trading rates

Certain Lloyds Banking Group companies, together with other panel banks, have been named as defendants in ongoing 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 London Interbank Offered Rate and the Australian BBSW reference rate.

Certain Lloyds Banking 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 claims against the Lloyds Banking Group in the UK relating 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 Lloyds Banking Group of any private lawsuits or any related challenges to the interpretation or validity of any of the Lloyds Banking Group's contractual arrangements, including their timing and scale. As such, it is not practicable to provide an estimate of any potential financial effect.

Tax authorities

The Lloyds Banking 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 Lloyds Banking Group that its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded their enquiry into the matter and issued a closure notice. The Lloyds Banking Group's interpretation of the UK rules has not changed and hence it has appealed to the First Tier Tax Tribunal, with a hearing expected in 2023. If the final determination of the matter by the judicial process is that HMRC's position is correct, management estimate that this would result in an increase in current tax liabilities of the Group of approximately £385 million (including interest). The Lloyds Banking Group, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

Other legal actions and regulatory matters

In addition, in the course of its 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, which could relate to a number of issues, including financial, environmental or other regulatory matters, both in the UK and overseas. Where material, such 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 based on 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 to assess properly 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. Where there is a contingent liability related to an existing provision the relevant disclosures are included within note 25.

Note 34: Contingent liabilities, commitments and guarantees (continued)

Contingent liabilities, commitments and guarantees

	The Group	
	2022 £m	2021 £m
Contingent liabilities	**97**	263

The contingent liabilities of the Group arise in the normal course of banking business and it is not practicable to quantify their future financial effect.

	The Group	
	2022 £m	2021 £m
Commitments and guarantees		
Forward asset purchases and forward deposits placed	**–**	6
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**15,307**	16,147
Other commitments and guarantees	**45,745**	24,794
	61,052	40,941
1 year or over original maturity	**4,136**	3,061
Total commitments and guarantees	**65,188**	44,008

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £17,458 million (2021: £18,740 million) for the Group were irrevocable.

Capital commitments

There was no capital expenditure contracted but not provided for at 31 December 2022 (2021: £nil).

Note 35: 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.

The Group	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	Total £m
At 31 December 2022							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	**3,004**	**3,004**
Items in the course of collection from banks	–	–	–	–	–	**47**	**47**
Financial assets at fair value through profit or loss	–	–	**291**	–	–	–	**291**
Derivative financial instruments	**65**	**3,412**	–	–	–	–	**3,477**
Loans and advances to banks	–	–	–	–	–	**271**	**271**
Loans and advances to customers	–	–	–	–	–	**292,416**	**292,416**
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	**13,982**	**13,982**
Financial assets at amortised cost	–	–	–	–	–	**306,669**	**306,669**
Financial assets at fair value through other comprehensive income	–	–	–	–	**103**	–	**103**
Total financial assets	**65**	**3,412**	**291**	–	**103**	**309,720**	**313,591**
Financial liabilities							
Deposits from banks	–	–	–	–	–	**195**	**195**
Customer deposits	–	–	–	–	–	**166,363**	**166,363**
Repurchase agreements	–	–	–	–	–	**30,210**	**30,210**
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	**88,180**	**88,180**
Items in course of transmission to banks	–	–	–	–	–	**118**	**118**
Financial liabilities at fair value through profit or loss	–	–	–	**26**	–	–	**26**
Derivative financial instruments	**1**	**4,543**	–	–	–	–	**4,544**
Notes in circulation	–	–	–	–	–	**1,280**	**1,280**
Debt securities in issue	–	–	–	–	–	**6,123**	**6,123**
Other	–	–	–	–	–	**550**	**550**
Subordinated liabilities	–	–	–	–	–	**2,456**	**2,456**
Total financial liabilities	**1**	**4,543**	–	**26**	–	**295,475**	**300,045**

Note 35: Financial instruments (continued)

The Group	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	Total £m
At 31 December 2021							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	3,201	3,201
Items in the course of collection from banks	–	–	–	–	–	47	47
Financial assets at fair value through profit or loss	–	–	362	–	–	–	362
Derivative financial instruments	280	3,904	–	–	–	–	4,184
Loans and advances to banks	–	–	–	–	–	102	102
Loans and advances to customers	–	–	–	–	–	279,409	279,409
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	15,181	15,181
Financial assets at amortised cost	–	–	–	–	–	294,692	294,692
Financial assets at fair value through other comprehensive income	–	–	–	–	2,179	–	2,179
Total financial assets	280	3,904	362	–	2,179	297,940	304,665
Financial liabilities							
Deposits from banks	–	–	–	–	–	597	597
Customer deposits	–	–	–	–	–	170,777	170,777
Repurchase agreements	–	–	–	–	–	30,028	30,028
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	74,789	74,789
Items in course of transmission to banks	–	–	–	–	–	98	98
Financial liabilities at fair value through profit or loss	–	–	–	33	–	–	33
Derivative financial instruments	48	4,109	–	–	–	–	4,157
Notes in circulation	–	–	–	–	–	1,321	1,321
Debt securities in issue	–	–	–	–	–	7,353	7,353
Other	–	–	–	–	–	627	627
Subordinated liabilities	–	–	–	–	–	2,562	2,562
Total financial liabilities	48	4,109	–	33	–	288,152	292,342

Note 35: Financial instruments (continued)

The Company	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	Held at amortised cost £m	Total £m
At 31 December 2022					
Financial assets					
Financial assets at fair value through profit or loss	**–**	**–**	**–**	**–**	**–**
Derivative financial instruments	**27**	**–**	**–**	**–**	**27**
Due from fellow Lloyds Banking Group undertakings	**–**	**–**	**–**	**3,209**	**3,209**
Total financial assets	**27**	**–**	**–**	**3,209**	**3,236**
Financial liabilities					
Due to fellow Lloyds Banking Group undertakings	**–**	**–**	**–**	**2,502**	**2,502**
Derivative financial instruments	**–**	**–**	**–**	**–**	**–**
Subordinated liabilities	**–**	**–**	**–**	**819**	**819**
Total financial liabilities	**–**	**–**	**–**	**3,321**	**3,321**
At 31 December 2021					
Financial assets					
Financial assets at fair value through profit or loss	–	–	384	–	384
Derivative financial instruments	81	82	–	–	163
Due from fellow Lloyds Banking Group undertakings	–	–	–	2,655	2,655
Total financial assets	81	82	384	2,655	3,202
Financial liabilities					
Due to fellow Lloyds Banking Group undertakings	–	–	–	1,879	1,879
Derivative financial instruments	–	80	–	–	80
Subordinated liabilities	–	–	–	1,208	1,208
Total financial liabilities	–	80	–	3,087	3,167

Note 35: Financial instruments (continued)

(2) Fair value measurement

Fair value is the price that would be received on sale of 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 to those 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, items in course of transmission to banks and notes in circulation.

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, premises and equipment, and shareholders' equity. These items are material and accordingly the Group believes that any fair value information presented would 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 lifecycle. 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 structured credit, over-the-counter options and the credit valuation adjustment (CVA), funding valuation adjustment (FVA) and other valuation adjustments.

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 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. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are 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 35: Financial instruments (continued)

(3) Financial assets and liabilities carried at fair value

(A) Financial assets, excluding derivatives

Valuation hierarchy

At 31 December 2022, the Group's financial assets carried at fair value, excluding derivatives, totalled £394 million (2021: £2,541 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 85). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2022				
Financial assets at fair value through profit or loss				
Loans and advances to customers	**–**	**–**	**291**	**291**
Financial assets at fair value through other comprehensive income				
Debt securities				
Government securities	**103**	**–**	**–**	**103**
Corporate and other debt securities	**–**	**–**	**–**	**–**
	103	**–**	**–**	**103**
Total financial assets carried at fair value, excluding derivatives	**103**	**–**	**291**	**394**
At 31 December 2021				
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	–	362	362
Financial assets at fair value through other comprehensive income				
Debt securities				
Government securities	132	–	–	132
Corporate and other debt securities	–	2,047	–	2,047
	132	2,047	–	2,179
Total financial assets carried at fair value, excluding derivatives	132	2,047	362	2,541

At 31 December 2022, the Company had no financial assets at fair value through profit or loss (2021: £384 million). The entire balance was classified as level 2.

Movements in level 3 portfolio

The table below analyses movements in level 3 financial assets, excluding derivatives, carried at fair value (recurring measurement).

	The Group	
The Group	**2022 £m**	2021 £m
At 1 January	**362**	477
Losses recognised in the income statement within other income	**(20)**	(78)
Purchases/increases to customer loans	**3**	4
Sales/repayments of customer loans	**(54)**	(41)
At 31 December	**291**	362
Losses recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**(19)**	(68)

Valuation methodology for financial assets, excluding derivatives

Loans and advances to customers

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.

Note 35: Financial instruments (continued)

(B) Financial liabilities, excluding derivatives

Valuation hierarchy

At 31 December 2022, the Group's financial liabilities carried at fair value, excluding derivatives, comprised its financial liabilities at fair value through profit or loss and totalled £26 million (2021: £33 million). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 85). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

The Group	2022 Level 1 £m	2022 Level 2 £m	2022 Level 3 £m	2022 Total £m	2021 Level 1 £m	2021 Level 2 £m	2021 Level 3 £m	2021 Total £m
Debt securities in issue designated at fair value through profit or loss	**–**	**–**	**26**	**26**	–	–	33	33

Movements in level 3 portfolio

The table below analyses movements in the level 3 financial liabilities portfolio, excluding derivatives.

The Group	2022 £m	2021 £m
At 1 January	**33**	45
Gains recognised in the income statement within other income	**(3)**	(5)
Redemptions	**(4)**	(7)
At 31 December	**26**	33
Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December	**(3)**	(4)

(C) Derivatives

Valuation hierarchy

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2022, such assets totalled £3,477 million for the Group (2021: £4,184 million for the Group) and liabilities totalled £4,544 million for the Group (2021: £4,157 million for the Group). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 85). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

The Group	2022 Level 1 £m	2022 Level 2 £m	2022 Level 3 £m	2022 Total £m	2021 Level 1 £m	2021 Level 2 £m	2021 Level 3 £m	2021 Total £m
Derivative assets	**–**	**3,477**	**–**	**3,477**	–	4,184	–	4,184
Derivative liabilities	**–**	**(4,394)**	**(150)**	**(4,544)**	–	(3,981)	(176)	(4,157)

At 31 December 2022, the Company had derivative assets of £27 million (2021: £163 million) and no derivative liabilities (2021: £80 million). These balances were classified as level 2.

Movements in level 3 portfolio

The table below analyses movements in level 3 derivative assets and liabilities carried at fair value.

The Group	2022 Derivative assets £m	2022 Derivative liabilities £m	2021 Derivative assets £m	2021 Derivative liabilities £m
At 1 January	**–**	**(176)**	12	(271)
Gains (losses) gains recognised in the income statement within other income	**–**	**1**	(12)	76
Redemptions	**–**	**25**	–	19
At 31 December	**–**	**(150)**	–	(176)
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December	**–**	**1**	–	69

Note 35: Financial instruments (continued)

Valuation methodology for derivatives

Where the Group's derivative assets and liabilities are not traded on an exchange, they are valued using valuation techniques, including discounted cash flow and options pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

- Interest rate swaps which are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from publicly quoted rates
- Foreign exchange derivatives that do not contain options which are priced using rates available from publicly quoted sources
- Credit derivatives which are valued using standard models with observable inputs, except for the items classified as level 3, which are valued using publicly available yield and credit default swap (CDS) curves
- Less complex interest rate and foreign exchange option products which are valued using volatility surfaces developed from publicly available interest rate cap, interest rate swaption and other option volatilities; option volatility skew information is derived from a market standard consensus pricing service. For more complex option products, the Group calibrates its models using observable at-the-money data; where necessary, the Group adjusts for out-of-the-money positions using a market standard consensus pricing service

Complex interest rate and foreign exchange products where inputs to the valuation are significant, 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.

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

The following table summarises the movement on this valuation adjustment account during 2021 and 2022:

	2022 £m	2021 £m
At 1 January	**88**	120
Income statement credit	**(52)**	(32)
At 31 December	**36**	88

Represented by:

	2022 £m	2021 £m
Credit Valuation Adjustment	**34**	73
Debit Valuation Adjustment	**(3)**	(3)
Funding Valuation Adjustment	**5**	18
	36	88

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 strong interbank collateral arrangements. These exposures largely relate to the provision of risk management solutions for corporate customers.

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
- Expectations of counterparty creditworthiness

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 £8 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 2022).

Note 35: Financial instruments (continued)

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
- The Group's own CDS spread

A one per cent rise in the CDS spread would lead to an increase in the DVA of £6 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 £15 million fall in the overall valuation adjustment to £16 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 £1 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 time frame 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 2022, the Group's derivative trading business held mid to bid-offer valuation adjustments of £1 million (2021: £2 million).

(D) Sensitivity of level 3 valuations

			2022			2021		
				Effect of reasonably possible alternative assumptions[1]			Effect of reasonably possible alternative assumptions[1]	
	Valuation techniques	**Significant unobservable inputs[2]**	**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) (+/- 50bps)[3]	**291**	**25**	**(23)**	362	31	(29)
Level 3 financial assets carried at fair value			**291**			362		
Financial liabilities at fair value through profit or loss								
Securitisation notes	Discounted cash flows	Interest rate spreads (+/- 50bps)[4]	**26**	**1**	**(1)**	33	1	(1)
Derivative financial liabilities								
Shared appreciation right	Market values – property valuation	HPI (+/- 1%)[5]	**150**	**16**	**(16)**	176	19	(18)
Level 3 financial liabilities carried at fair value			**176**			209		

1 Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.
2 Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.
3 2021: -50bps/106bps
4 2021: +/- 50bps
5 2021: +/- 1%

Unobservable inputs

Significant unobservable inputs affecting the valuation of debt securities 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
- Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes

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.

Note 35: Financial instruments (continued)

(4) Financial assets and liabilities carried at amortised cost

(A) Financial assets

Valuation hierarchy

The table below analyses the fair values of those financial assets of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 85). 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.

The Group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2022					
Loans and advances to banks	**271**	**271**	**–**	**–**	**271**
Loans and advances to customers	**292,416**	**285,540**	**–**	**–**	**285,540**
Due from fellow Lloyds Banking Group undertakings	**13,982**	**13,982**	**–**	**–**	**13,982**
At 31 December 2021					
Loans and advances to banks	102	102	–	–	102
Loans and advances to customers	279,409	282,369	–	–	282,369
Due from fellow Lloyds Banking Group undertakings	15,181	15,181	–	–	15,181

Valuation methodology

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 other 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.

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 variable rate loans and balances 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 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.

Notes to the accounts

Note 35: Financial instruments (continued)

(B) Financial liabilities

Valuation hierarchy

The table below analyses the fair values of those financial liabilities of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 85).

The Group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2022					
Deposits from banks	**195**	**195**	**–**	**195**	**–**
Customer deposits	**166,363**	**166,264**	**–**	**166,264**	**–**
Repurchase agreements	**30,210**	**30,210**	**–**	**30,210**	**–**
Due to fellow Lloyds Banking Group undertakings	**88,180**	**88,180**	**–**	**88,180**	**–**
Debt securities in issue	**6,123**	**6,122**	**–**	**6,122**	**–**
Subordinated liabilities	**2,456**	**2,475**	**–**	**2,475**	**–**
At 31 December 2021					
Deposits from banks	597	597	–	597	–
Customer deposits	170,777	170,842	–	170,842	–
Repurchase agreements	30,028	30,028	–	30,028	–
Due to fellow Lloyds Banking Group undertakings	74,789	74,789	–	74,789	–
Debt securities in issue	7,353	7,425	–	7,425	–
Subordinated liabilities	2,562	2,728	–	2,728	–

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.

Repurchase agreements

The carrying amount is deemed a reasonable approximation of fair value given the short-term nature of these instruments.

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 in issue 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.

(5) Reclassifications of financial assets

There have been no reclassifications of financial assets in 2021 or 2022.

Note 36: 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 21, 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 or 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 while 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 21). The liabilities shown in the table below have recourse to the transferred assets.

	2022		2021	
The Group	**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 other comprehensive income	**–**	**–**	24	–
Securitisation programmes				
Financial assets at amortised cost:				
Loans and advances to customers[1]	**24,811**	**773**	22,101	1,687

1 The carrying value of associated liabilities for the Group excludes securitisation notes held by the Group of £21,403 million (31 December 2021: £19,037 million).

Note 37: 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[1]		
	Gross amounts of assets and liabilities[2] £m	Amount offset in the balance sheet £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
At 31 December 2022						
Financial assets						
Financial assets at fair value through profit or loss	**291**	**–**	**291**	**–**	**–**	**291**
Derivative financial instruments	**3,477**	**–**	**3,477**	**(217)**	**(3,042)**	**218**
Loans and advances to banks	**271**	**–**	**271**	**(171)**	**–**	**100**
Loans and advances to customers	**292,416**	**–**	**292,416**	**(18)**	**(594)**	**291,804**
Financial assets at fair value through other comprehensive income	**103**	**–**	**103**	**–**	**–**	**103**
Financial liabilities						
Deposits from banks	**195**	**–**	**195**	**(194)**	**–**	**1**
Customer deposits	**166,363**	**–**	**166,363**	**(23)**	**(594)**	**165,746**
Repurchase agreements	**30,210**	**–**	**30,210**	**–**	**(30,210)**	**–**
Financial liabilities at fair value through profit or loss	**26**	**–**	**26**	**–**	**–**	**26**
Derivative financial instruments	**4,544**	**–**	**4,544**	**(189)**	**(3,096)**	**1,259**
At 31 December 2021						
Financial assets						
Financial assets at fair value through profit or loss	362	–	362	–	–	362
Derivative financial instruments	4,184	–	4,184	(712)	(350)	3,122
Loans and advances to banks	102	–	102	(42)	–	60
Loans and advances to customers	279,409	–	279,409	(12)	(305)	279,092
Financial assets at fair value through other comprehensive income	2,179	–	2,179	–	–	2,179
Financial liabilities						
Deposits from banks	597	–	597	(596)	–	1
Customer deposits	170,777	–	170,777	(116)	(305)	170,356
Repurchase agreements	30,028	–	30,028	–	(30,028)	–
Financial liabilities at fair value through profit or loss	33	–	33	–	–	33
Derivative financial instruments	4,157	–	4,157	(54)	(1,237)	2,866

1 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.

2 Net of impairment allowances.

The effects of over-collateralisation have not been taken into account in the above table.

Note 38: Financial risk management

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: market risk, which includes interest rate risk and foreign exchange risk; credit risk; liquidity risk and capital risk. The following disclosures provide quantitative and qualitative information about the Group's exposure to these risks.

Market risk

(A) Interest rate risk

Interest rate risk arises from the different repricing characteristics of the Group's assets and liabilities. Liabilities are generally 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 UK Bank Rate, set by the Bank of England. The rates on the remaining liabilities 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 while managing its market risk exposures within the risk appetite defined by the Lloyds Banking Group 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 Lloyds Banking Group's structural hedge. The Lloyds Banking Group's 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 Lloyds Banking Group Asset and Liability Committee.

The Lloyds Banking Group establishes hedge accounting relationships for interest rate risk using cash flow hedges and fair value hedges. The Lloyds Banking 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 Lloyds Banking Group structural hedge may be designated into cash flow hedges to manage income statement volatility. The economic items related to the Lloyds Banking Group structural hedge, for example current accounts, are not eligible hedged items under IAS 39 for inclusion into accounting hedge relationships. The Lloyds Banking 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 Lloyds Banking 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 2022 the aggregate notional principal of interest rate swaps designated as fair value hedges was £1,291 million (2021: £2,823 million) for the Group with a net fair value asset of £64 million (2021: asset of £232 million) for the Group (note 12). There were losses recognised on the hedging instruments of £170 million (2021: losses of £190 million) for the Group. There were gains on the hedged items attributable to the hedged risk of £170 million (2021: gains of £193 million) for the Group. The gains and losses relating to the fair value hedges are recorded in net trading income.

The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2022 and 2021 was £nil (2021: £nil) for the Group. In 2022, ineffectiveness recognised in the income statement that arises from cash flow hedges was £nil (2021: loss of £3 million).

Interest rate benchmark reform

The Group continues to manage the transition to alternative benchmark rates under its Group-wide IBOR transition programme. The Group has transitioned substantially all of its non-USD LIBOR products and continues to work with customers to transition a small number of remaining contracts that either have yet to transition or have defaulted to the relevant synthetic LIBOR benchmark in the interim. USD LIBOR transition is being managed through the Group's existing processes, either transitioning to an alternative benchmark rate or allowed to fallback under existing contract protocols or through US legislation and is expected to complete by 30 June 2023.

While the volume of outstanding transactions impacted by IBOR benchmark reforms continues to reduce, the Group does not expect material changes to its risk management approach.

(B) Foreign exchange 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 managed centrally within allocated exposure limits. Trading book exposures in the authorised trading centres are allocated exposure limits. The limits are monitored daily by the local centres and reported to the central market and liquidity risk function in London.

The Group manages foreign currency accounting exposure via cash flow hedge accounting, utilising currency swaps and forward foreign exchange trades.

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 hedge accounting of the currency translation risk of the net investment in foreign operations in 2018.

The Group has overseas operations in Europe. Structural foreign currency exposures in respect of operations with a Euro functional currency are £179 million (2021: £119 million) for the Group.

Note 38: 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. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems as inputs and assess credit risk at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the current exposures to the counterparty and their likely future development, from which the Group derives the exposure at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The Group uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers, such as asset sales and credit derivatives based transactions.

(A) Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	2022			2021		
The Group	**Maximum exposure £m**	**Offset[1] £m**	**Net exposure £m**	Maximum exposure £m	Offset[1] £m	Net exposure £m
Financial assets at fair value through profit or loss:						
Loans and advances	**291**	**–**	**291**	362	–	362
Derivative financial instruments	**3,477**	**(154)**	**3,323**	4,184	(350)	3,834
Financial assets at amortised cost, net[2]:						
Loans and advances to banks, net[2]	**271**	**–**	**271**	102	–	102
Loans and advances to customers, net[2]	**292,416**	**(594)**	**291,822**	279,409	(305)	279,104
	292,687	**(594)**	**292,093**	279,511	(305)	279,206
Financial assets at fair value through other comprehensive income	**103**	**–**	**103**	2,179	–	2,179
Off-balance sheet items:						
Other items serving as direct credit substitutes	**2**	**–**	**2**	58	–	58
Performance bonds, including letters of credit, and other transaction-related contingencies	**95**	**–**	**95**	205	–	205
Irrevocable commitments and guarantees	**17,458**	**–**	**17,458**	18,740	–	18,740
	17,555	**–**	**17,555**	19,003	–	19,003
	314,113	**(748)**	**313,365**	305,239	(655)	304,584

1 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.

2 Amounts shown net of related impairment allowances.

Note 38: Financial risk management (continued)

(B) Concentrations of exposure

The Group's management of concentration risk includes 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 Lloyds Banking Group's risk appetite and restrict exposure to higher risk countries and potentially vulnerable sectors and asset classes. Exposures are monitored to prevent both an excessive concentration of risk and single name concentrations. The Group's largest credit limits are regularly monitored by the Lloyds Banking Group Board Risk Committee and reported in accordance with regulatory requirements. As part of its credit risk policy, the Group considers sustainability risk (which incorporates Environmental (including climate), Social and Governance) in the assessment of commercial facilities.

At 31 December 2022 the most significant concentrations of exposure were in mortgages (comprising 92 per cent of total loans and advances to customers) and in other personal lending (comprising 5 per cent of the total).

Loans and advances to customers

	The Group	
	2022 £m	2021 £m
Agriculture, forestry and fishing	**585**	578
Energy and water supply	**62**	65
Manufacturing	**161**	240
Construction	**701**	693
Transport, distribution and hotels	**2,624**	2,473
Postal and telecommunications	**81**	97
Property companies	**3,007**	3,216
Financial, business and other services	**874**	1,197
Personal:		
Mortgages	**271,243**	264,099
Other	**15,764**	8,870
Lease financing	**172**	213
Hire purchase	**339**	247
Total loans and advances to customers before allowance for impairment losses	**295,613**	281,988
Allowance for impairment losses (note 13)	**(3,197)**	(2,579)
Total loans and advances to customers	**292,416**	279,409

The Group's operations are predominantly UK-based and as a result an analysis of credit risk exposures by geographical region is not provided.

(C) Credit quality of assets

Loans and advances

The Group uses two credit ratings systems, according to the characteristics of 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.

RMS		**CMS**	
Quality classification	**IFRS 9 PD range**	**Quality classification**	**IFRS 9 PD range**
RMS 1–3	0.00–0.80%	CMS 1–5	0.000–0.100%
RMS 4–6	0.81–4.50%	CMS 6–10	0.101–0.500%
RMS 7–9	4.51–14.00%	CMS 11–14	0.501–3.000%
RMS 10	14.01–20.00%	CMS 15–18	3.001–20.000%
RMS 11–13	20.01–99.99%	CMS 19	20.001–99.999%
RMS 14	100.00%	CMS 20–23	100.000%

Stage 3 assets of the Group include balances of £109 million (2021: £113 million) (with outstanding amounts due of £444 million (2021: £323 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 of the Group with a carrying amount of £120 million (2021: £612 million) were modified during the year. No material gain or loss was recognised by the Group.

As at 31 December 2022 assets that had been previously modified while classified as Stage 2 or Stage 3 and were classified as Stage 1 amounted to £3,668 million (31 December 2021: £4,568 million).

Note 38: Financial risk management (continued)

The Group – Gross drawn exposures and expected credit loss allowance	Drawn exposures Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Expected credit loss allowance Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2022								
Loans and advances to banks								
CMS 1–5	210	–	–	210	–	–	–	–
CMS 6–10	61	–	–	61	–	–	–	–
CMS 11–14	–	–	–	–	–	–	–	–
CMS 15–18	–	–	–	–	–	–	–	–
CMS 19	–	–	–	–	–	–	–	–
CMS 20–23	–	–	–	–	–	–	–	–
	271	–	–	271	–	–	–	–
Loans and advances to customers								
RMS 1–3	222,564	22,179	–	244,743	88	176	–	264
RMS 4–6	13,913	12,503	–	26,416	99	219	–	318
RMS 7–9	1,819	3,998	–	5,817	70	248	–	318
RMS 10	24	1,064	–	1,088	2	89	–	91
RMS 11–13	9	3,314	–	3,323	2	349	–	351
RMS 14	–	–	5,976	5,976	–	–	900	900
	238,329	43,058	5,976	287,363	261	1,081	900	2,242
CMS 1–5	1,216	–	–	1,216	–	–	–	–
CMS 6–10	1,412	24	–	1,436	1	–	–	1
CMS 11–14	2,293	500	–	2,793	11	7	–	18
CMS 15–18	619	573	–	1,192	11	36	–	47
CMS 19	4	71	–	75	–	8	–	8
CMS 20–23	–	–	1,538	1,538	–	–	881	881
	5,544	1,168	1,538	8,250	23	51	881	955
Central adjustment	–	–	–	–	–	–	–	–
Total loans and advances to customers	243,873	44,226	7,514	295,613	284	1,132	1,781	3,197

The Group – Gross undrawn exposures and expected credit loss allowance	Undrawn exposures Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Expected credit loss allowance Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2022								
RMS 1–3	45,478	192	–	45,670	16	–	–	16
RMS 4–6	11,664	2,455	–	14,119	26	26	–	52
RMS 7–9	556	400	–	956	7	14	–	21
RMS 10	2	60	–	62	–	4	–	4
RMS 11–13	–	112	–	112	–	11	–	11
RMS 14	–	–	68	68	–	–	–	–
	57,700	3,219	68	60,987	49	55	–	104
CMS 1–5	655	–	–	655	–	–	–	–
CMS 6–10	2,716	1	–	2,717	1	–	–	1
CMS 11–14	673	61	–	734	2	2	–	4
CMS 15–18	31	61	–	92	1	4	–	5
CMS 19	–	1	–	1	–	–	–	–
CMS 20–23	–	–	2	2	–	–	1	1
	4,075	124	2	4,201	4	6	1	11
Total	61,775	3,343	70	65,188	53	61	1	115

Note 38: Financial risk management (continued)

	Drawn exposures				Expected credit loss allowance			
The Group – Gross drawn exposures and expected credit loss allowance	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2021								
Loans and advances to banks								
CMS 1–5	96	–	–	96	–	–	–	–
CMS 6–10	6	–	–	6	–	–	–	–
CMS 11–14	–	–	–	–	–	–	–	–
CMS 15–18	–	–	–	–	–	–	–	–
CMS 19	–	–	–	–	–	–	–	–
CMS 20–23	–	–	–	–	–	–	–	–
	102	–	–	102	–	–	–	–
Loans and advances to customers								
RMS 1–3	236,919	10,022	–	246,941	57	184	–	241
RMS 4–6	6,821	9,506	–	16,327	56	191	–	247
RMS 7–9	784	3,578	–	4,362	27	164	–	191
RMS 10	8	588	–	596	1	43	–	44
RMS 11–13	11	1,876	–	1,887	–	180	–	180
RMS 14	–	–	4,041	4,041	–	–	665	665
	244,543	25,570	4,041	274,154	141	762	665	1,568
CMS 1–5	1,201	1	–	1,202	–	–	–	–
CMS 6–10	1,302	–	–	1,302	1	–	–	1
CMS 11–14	2,797	361	–	3,158	8	7	–	15
CMS 15–18	162	453	–	615	2	37	–	39
CMS 19	2	35	–	37	–	4	–	4
CMS 20–23	–	–	1,520	1,520	–	–	712	712
	5,464	850	1,520	7,834	11	48	712	771
Central adjustment	–	–	–	–	240	–	–	240
Total loans and advances to customers	250,007	26,420	5,561	281,988	392	810	1,377	2,579

	Undrawn exposures				Expected credit loss allowance			
The Group – Gross undrawn exposures and expected credit loss allowance	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2021								
RMS 1–3	35,251	137	–	35,388	13	–	–	13
RMS 4–6	2,951	1,405	–	4,356	10	19	–	29
RMS 7–9	107	85	–	192	2	3	–	5
RMS 10	–	15	–	15	–	1	–	1
RMS 11–13	–	28	–	28	–	2	–	2
RMS 14	–	–	44	44	–	–	–	–
	38,309	1,670	44	40,023	25	25	–	50
CMS 1–5	1,233	–	–	1,233	–	–	–	–
CMS 6–10	1,963	–	–	1,963	–	–	–	–
CMS 11–14	569	149	–	718	1	3	–	4
CMS 15–18	10	59	–	69	–	1	–	1
CMS 19	–	–	–	–	–	–	–	–
CMS 20–23	–	–	2	2	–	–	1	1
	3,775	208	2	3,985	1	4	1	6
Total	42,084	1,878	46	44,008	26	29	1	56

Note 38: Financial risk management (continued)

Cash and balances at central banks

Significantly all of the Group's cash and balances at central banks of £3,004 million (2021: £3,201 million) are due from the Bank of England.

Financial assets at fair value through other comprehensive income

The credit quality of financial assets at fair value through other comprehensive income is set out below:

The Group	2022 Investment grade[1] £m	2022 Other[2] £m	2022 Total £m	2021 Investment grade[1] £m	2021 Other[2] £m	2021 Total £m
Debt securities:						
Government securities	**103**	**–**	**103**	132	–	132
Corporate and other debt securities	**–**	**–**	**–**	2,003	44	2,047
Total financial assets at fair value through other comprehensive income	**103**	**–**	**103**	2,135	44	2,179

1 Credit ratings equal to or better than 'BBB'.
2 Other comprises not rated (2022: £nil; 2021: £44 million).

Derivative assets

An analysis of derivative assets is given in note 12. 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 credit risk relating to derivative assets of £3,323 million for the Group (2021: £3,834 million for the Group), cash collateral of £217 million for the Group (2021: £712 million for the Group) was held and a further £8 million for the Group (2021: £35 million for the Group) was due from OECD banks.

The Group	2022 Investment grade[1] £m	2022 Other[2] £m	2022 Total £m	2021 Investment grade[1] £m	2021 Other[2] £m	2021 Total £m
Trading and other	**398**	**170**	**568**	1,141	693	1,834
Hedging	**8**	**–**	**8**	19	–	19
	406	**170**	**576**	1,160	693	1,853
Due from fellow Lloyds Banking Group undertakings			**2,901**			2,331
Total derivative financial instruments			**3,477**			4,184

1 Credit ratings equal to or better than 'BBB'.
2 Other comprises sub-investment grade (2022: £105 million; 2021: £580 million) and not rated (2022: £65 million; 2021: £113 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.

Note 38: Financial risk management (continued)

(D) Collateral held as security for financial assets

The principal types of collateral accepted by the Group include: residential and commercial properties; charges over business assets such as premises, inventory and accounts receivable; financial instruments, cash and guarantees from third-parties. The terms and conditions associated with the use of the collateral are varied and are dependent on the type of agreement and the counterparty. 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.

Loans and advances to banks

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. The market takes into account many factors, including environmental considerations such as flood risk and energy efficient additions, in arriving at the value of a home.

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.

	2022				2021			
The Group	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total gross £m**	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total gross £m
Less than 70 per cent	**180,384**	**31,457**	**4,842**	**216,683**	182,922	21,843	2,970	207,735
70 per cent to 80 per cent	**30,162**	**5,024**	**340**	**35,526**	40,313	1,722	325	42,360
80 per cent to 90 per cent	**11,499**	**2,501**	**134**	**14,134**	11,509	299	138	11,946
90 per cent to 100 per cent	**3,215**	**643**	**82**	**3,940**	718	109	79	906
Greater than 100 per cent	**10**	**161**	**185**	**356**	145	212	190	547
Total	**225,270**	**39,786**	**5,583**	**270,639**	235,607	24,185	3,702	263,494

Commercial lending

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 2022, Stage 3 secured commercial lending amounted to £nil, net of an impairment allowance of £73 million (2021: £429 million, net of an impairment allowance of £72 million). The fair value of the collateral held in respect of impaired secured commercial lending was £43 million (2021: £73 million) for the Group. In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured commercial lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

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.

Note 38: Financial risk management (continued)

Financial assets at fair value through profit or loss

Securities held as collateral in the form of stock borrowed amounted to £2,055 million for the Group (2021: £3,025 million for the Group). Of this amount, £74 million for the Group (2021: £424 million for the Group) 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 £3,323 million for the Group (2021: £3,834 million for the Group), cash collateral of £217 million for the Group (2021: £712 million for the Group) was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2022, there were irrevocable loan commitments and other credit-related contingencies of £17,555 million for the Group (2021: £19,003 million for the Group). Collateral is held as security, in the event that lending is drawn down, on £15,307 million for the Group (2021: £16,147 million for the Group) of these balances.

Collateral repossessed

During the year, £198 million for the Group of collateral was repossessed (2021: £80 million for the Group), 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

As at 31 December 2022 there were balances arising from repurchase transactions with banks of £30,210 million for the Group (2021: £30,028 million for the Group), which include amounts due under the Bank of England's Term Funding Scheme with additional incentives for SMEs (TFSME); the fair value of the collateral provided under these agreements at 31 December 2022 was £38,544 million for the Group (2021: £39,875 million for the Group).

Securities lending transactions

The following on-balance sheet financial assets have been lent to counterparties under securities lending transactions:

	The Group	
	2022 £m	2021 £m
Financial assets at fair value through other comprehensive income	–	24

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 21.

Note 38: Financial risk management (continued)

Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. 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.

The table below analyses financial instrument liabilities of the Group 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.

The Group's liabilities may mature earlier or later than implied by their contractual terms and readers are, therefore, advised to use caution when using this data to evaluate the Group's liquidity position. In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. However, in practice, these deposits are not usually withdrawn on their contractual maturity.

The Group	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 2022						
Deposits from banks	**1**	**–**	**–**	**195**	**1**	**197**
Customer deposits	**156,411**	**2,027**	**5,074**	**3,396**	**3**	**166,911**
Repurchase agreements	**216**	**–**	**904**	**33,054**	**38**	**34,212**
Financial liabilities at fair value through profit or loss	**–**	**–**	**–**	**–**	**26**	**26**
Debt securities in issue	**183**	**40**	**2,176**	**4,089**	**1,405**	**7,893**
Lease liabilities	**1**	**22**	**64**	**259**	**259**	**605**
Subordinated liabilities	**–**	**125**	**199**	**2,014**	**487**	**2,825**
Total non-derivative financial liabilities	**156,812**	**2,214**	**8,417**	**43,007**	**2,219**	**212,669**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**85**	**28**	**68**	**646**	**1,615**	**2,442**
Gross settled derivatives – inflows	**(50)**	**(7)**	**(68)**	**(652)**	**(1,597)**	**(2,374)**
Gross settled derivatives – net flows	**35**	**21**	**–**	**(6)**	**18**	**68**
Net settled derivative liabilities	**265**	**–**	**–**	**–**	**37**	**302**
Total derivative financial liabilities	**300**	**21**	**–**	**(6)**	**55**	**370**
At 31 December 2021						
Deposits from banks	–	–	–	599	–	599
Customer deposits	163,248	550	2,996	4,266	5	171,065
Repurchase agreements	9	10	170	30,994	–	31,183
Financial liabilities at fair value through profit or loss	–	–	–	–	33	33
Debt securities in issue	1	20	3,155	3,842	475	7,493
Lease liabilities	1	29	75	272	396	773
Subordinated liabilities	22	22	31	2,320	549	2,944
Total non-derivative financial liabilities	163,281	631	6,427	42,293	1,458	214,090
Derivative financial liabilities:						
Gross settled derivatives – outflows	32	29	404	865	647	1,977
Gross settled derivatives – inflows	(10)	(18)	(400)	(838)	(639)	(1,905)
Gross settled derivatives – net flows	22	11	4	27	8	72
Net settled derivative liabilities	475	–	–	–	40	515
Total derivative financial liabilities	497	11	4	27	48	587

The Company	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 2022						
Subordinated liabilities	**–**	**–**	**192**	**488**	**355**	**1,035**
At 31 December 2021						
Subordinated liabilities	–	17	28	641	751	1,437

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of £4 million (2021: £7 million) per annum for the Group and £1 million (2021: £1 million) for the Company which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

Note 38: Financial risk management (continued)

The following table sets out the amounts and residual maturities of the Group's off-balance sheet contingent liabilities, commitments and guarantees.

The Group	Within 1 year £m	1–3 years £m	3–5 years £m	Over 5 years £m	Total £m
At 31 December 2022					
Total contingent liabilities	**17**	**8**	**1**	**71**	**97**
Lending commitments and guarantees	**61,052**	**1,122**	**683**	**2,331**	**65,188**
Other commitments	**–**	**–**	**–**	**–**	**–**
Total commitments and guarantees	**61,052**	**1,122**	**683**	**2,331**	**65,188**
Total contingents, commitments and guarantees	**61,069**	**1,130**	**684**	**2,402**	**65,285**
At 31 December 2021					
Total contingent liabilities	135	26	30	72	263
Lending commitments and guarantees	40,941	1,461	592	1,008	44,002
Other commitments	–	–	–	6	6
Total commitments and guarantees	40,941	1,461	592	1,014	44,008
Total contingents, commitments and guarantees	41,076	1,487	622	1,086	44,271

Capital risk

Capital is actively managed on an ongoing basis for the Group's principal banking subsidiary, Bank of Scotland plc, and the associated capital policies and procedures are subject to regular review. Bank of Scotland plc measures both its capital requirements and the amount of capital resources that it holds to meet those requirements through applying capital directives and regulations as implemented in the UK by the Prudential Regulation Authority (PRA) and supplemented through additional regulation under the PRA Rulebook and associated statements of policy, supervisory statements and other guidance. Regulatory capital ratios are considered a key part of the budgeting and planning processes and forecast ratios are reviewed by the Lloyds Banking Group and Ring-Fenced Banks Asset and Liability Committees. Target capital levels take account of current and future regulatory requirements, capacity for growth and to cover uncertainties.

Note 39: Cash flow statements

(A) Change in operating assets

	The Group		The Company	
	2022 £m	2021[1] £m	**2022 £m**	2021 £m
Change in amounts due from fellow Lloyds Banking Group undertakings	**1,190**	4,671	**1**	3,449
Change in other financial assets held at amortised cost	**(7,550)**	(15,316)	**–**	–
Change in financial assets at fair value through profit or loss	**71**	115	**384**	1,810
Change in derivative financial instruments	**711**	3,106	**136**	55
Change in other operating assets	**(149)**	158	**1**	1
Change in operating assets	**(5,727)**	(7,266)	**522**	5,315

1 Restated, see page 30.

(B) Change in operating liabilities

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Change in deposits from banks	**(402)**	(418)	**–**	–
Change in customer deposits	**(4,414)**	7,776	**–**	–
Change in repurchase agreements	**182**	16,348	**–**	–
Change in amounts due to fellow Lloyds Banking Group undertakings	**8,121**	(12,165)	**623**	(6,535)
Change in financial liabilities at fair value through profit or loss	**(7)**	(12)	**–**	–
Change in derivative financial instruments	**387**	(4,295)	**(80)**	(29)
Change in debt securities in issue	**(1,230)**	(944)	**–**	–
Change in other operating liabilities[1]	**(134)**	(2)	**–**	(4)
Change in operating liabilities	**2,503**	6,288	**543**	(6,568)

1 Includes £77 million (2021: £72 million) for the Group in respect of lease liabilities.

Note 39: Cash flow statements (continued)

(C) Non-cash and other items

	The Group		The Company	
	2022 £m	2021 £m	**2022 £m**	2021 £m
Depreciation and amortisation	**224**	284	**–**	–
Dividends received from subsidiary undertakings	**–**	–	**–**	(1,200)
Allowance for loan losses	**600**	(302)	**–**	–
Write-off of allowance for loan losses, net of recoveries	**(256)**	(320)	**–**	–
Impairment (credit) charge relating to undrawn balances	**30**	(72)	**–**	–
Regulatory and legal provisions	**91**	982	**–**	–
Other provision movements	**(38)**	3	**–**	–
Additional capital injections to subsidiaries	**–**	–	**(46)**	(36)
Net charge in respect of defined benefit schemes	**66**	113	**67**	112
Foreign exchange impact on balance sheet[1]	**506**	(15)	**(326)**	(40)
Interest expense on subordinated liabilities	**100**	99	**43**	73
Other non-cash items	**(23)**	(4)	**–**	47
Total non-cash items	**1,300**	768	**(262)**	(1,044)
Contributions to defined benefit schemes	**(915)**	(512)	**(915)**	(512)
Payments in respect of regulatory and legal provisions	**(392)**	(377)	**–**	–
Liability management	**–**	(7)	**–**	47
Total other items	**(1,307)**	(896)	**(915)**	(465)
Non-cash and other items	**(7)**	(128)	**(1,177)**	(1,509)

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

	The Group		The Company	
	2022 £m	2021[1] £m	**2022 £m**	2021 £m
Cash and balances at central banks	**3,004**	3,201	**–**	–
Less mandatory reserve deposits[2]	**(977)**	(1,044)	**–**	–
	2,027	2,157	**–**	–
Loans and advances to banks	**271**	102	**–**	–
Less amounts with a maturity of three months or more	**(211)**	(74)	**–**	–
	60	28	**–**	–
Due from fellow Lloyds Banking Group Undertakings	**–**	–	**3,135**	2,580
Total cash and cash equivalents	**2,087**	2,185	**3,135**	2,580

1 Restated, see page 30.

2 Mandatory reserve deposits are held with local central banks in accordance with statutory requirements. Where these deposits are not held in demand accounts and are not available to finance the Group's day-to-day operations they are excluded from cash and cash equivalents.

Note 40: Other information

HBOS plc is incorporated as a public limited company and registered in Scotland with the registered number SC218813. HBOS plc's registered office is The Mound, Edinburgh, EH1 1YZ, and its principal executive offices are located at 25 Gresham Street, London, EC2V 7HN.

HBOS plc and its subsidiaries form a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services.

HBOS plc's immediate parent undertaking is Lloyds Bank plc and its ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland. Copies of the consolidated Annual Report and Accounts of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

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 2022. 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 per cent 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. All material subsidiary undertakings are consolidated by Lloyds Banking Group.

Name of undertaking	Notes
Anglo Scottish Utilities Partnership	+ *
Automobile Association Personal Finance Ltd	4 i
Bank of Scotland (B G S) Nominees Ltd	5 *
Bank of Scotland Branch Nominees Ltd	5 i
Bank of Scotland Central Nominees Ltd	5 *
Bank of Scotland Edinburgh Nominees Ltd	5 *
Bank of Scotland Equipment Finance Ltd	9 i ‡
Bank of Scotland plc	5 i v
Bank of Scotland Structured Asset Finance Ltd	1 i
Bank of Scotland Transport Finance 1 Ltd	9 i ‡
Bank of Wales Ltd	7 i
Barents Leasing Ltd	1 i
Birmingham Midshires Financial Services Ltd	4 i ‡
Birmingham Midshires Mortgage Services Ltd	9 i ‡
BOS (Ireland) Property Services 2 Ltd	8 i
BOS (Shared Appreciation Mortgages (Scotland)) Ltd	4 i
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Ltd	4 i
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Ltd	4 i
BOS (Shared Appreciation Mortgages) No. 1 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 2 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 3 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 4 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 5 plc	4 i
BOS (Shared Appreciation Mortgages) No. 6 plc	4 i
BOS Personal Lending Ltd	4 ii iii
BOSSAF Rail Ltd	1 i
British Linen Leasing (London) Ltd	5 i
British Linen Leasing Ltd	5 i
British Linen Shipping Ltd	5 i
Capital 1945 Ltd	7 i
Capital Bank Leasing 3 Ltd	9 i ‡
Capital Bank Leasing 5 Ltd	7 i
Capital Bank Leasing 12 Ltd	5 i
Capital Bank Property Investments (3) Ltd	7 i
Capital Personal Finance Ltd	4 i
CF Asset Finance Ltd	9 i ‡
First Retail Finance (Chester) Ltd	4 i
Forthright Finance Ltd	7 i
Halifax Group Ltd	4 i
Halifax Leasing (March No.2) Ltd	1 i
Halifax Leasing (September) Ltd	1 i
Halifax Ltd	4 i
Halifax Loans Ltd	4 i
Halifax Share Dealing Ltd	4 i
Halifax Vehicle Leasing (1998) Ltd	4 i
HBOS Covered Bonds LLP	4 *
HBOS Final Salary Trust Ltd	5 i
HBOS Social Housing Covered Bonds LLP	7 *
HBOS UK Ltd	5 i
Home Shopping Personal Finance Ltd	4 i
HSDL Nominees Ltd	4 i
IBOS Finance Ltd	7 i
Intelligent Finance Software Ltd	4 i ‡
Lex Vehicle Leasing (Holdings) Ltd	9 ii iii iv ‡
Lex Vehicle Leasing Ltd	9 i ‡
Lloyds Capital GP Ltd	10 i
Lloyds Secretaries Ltd	1 i
Loans.co.uk Ltd	7 i
MBNA Ltd	7 i
Membership Services Finance Ltd	4 i
NFU Mutual Finance Ltd	7 ii vi #
Nordic Leasing Ltd	9 i ‡
NWS Trust Ltd	5 i
Pacific Leasing Ltd	1 i
Seabreeze Leasing Ltd	1 i
Seaspirit Leasing Ltd	1 i
Sharedealing Nominees Ltd	4 i
Standard Property Investment (1987) Ltd	5 ii #
Sussex County Homes Ltd	4 i
The British Linen Company Ltd	5 i
The Mortgage Business plc	4 i
Thistle Leasing	+ *
Tower Hill Property Investments (7) Ltd	7 i #
Tower Hill Property Investments (10) Ltd	7 i #
Tranquility Leasing Ltd	1 i
Waymark Asset Investments Ltd	1 ii iii

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	2
Deva Financing Holdings Ltd	3
Deva Financing plc	11 ‡
Edgbaston RMBS 2010-1 plc	11 ‡
Edgbaston RMBS Holdings Ltd	3
Elland RMBS 2018 plc	3
Elland RMBS Holdings Ltd	3
Molineux RMBS 2016-1 plc	3
Molineux RMBS Holdings Ltd	3
Penarth Asset Securitisation Holdings Ltd	3
Penarth Funding 1 Ltd	3
Penarth Funding 2 Ltd	3
Penarth Master Issuer plc	3
Penarth Receivables Trustee Ltd	3
Permanent Funding (No. 1) Ltd	3
Permanent Funding (No. 2) Ltd	3
Permanent Holdings Ltd	3
Permanent Master Issuer plc	3
Permanent Mortgages Trustee Ltd	3
Permanent PECOH Holdings Ltd	3

Subsidiaries and related undertakings

Name of undertaking	Notes
Permanent PECOH Ltd	3
Syon Securities 2019 DAC	6
Syon Securities 2020 DAC	6
Syon Securities 2020-2 DAC	6
Wilmington Cards 2021-1 plc	3
Wilmington Cards Holdings Ltd	3
Wilmington Receivables Trustee Ltd	3

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	Notes
Addison Social Housing Ltd	20%	1 Bartholomew Lane, London, EC2N 2AX	i
Connery Ltd	20%	44 Esplanade, St. Helier, Jersey, JE4 9WG	i &

Notes	
*	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
&	The Group holds voting rights of between 20% and 49.9%
‡	The undertaking is in liquidation
i	Ordinary shares
ii	A Ordinary shares
iii	B Ordinary shares
iv	Redeemable preference shares
v	Preference shares
vi	C Ordinary shares

Registered office addresses	
1	25 Gresham Street, London, EC2V 7HN
2	44 Esplanade, St. Helier, Jersey, JE4 9WG
3	1 Bartholomew Lane, London, EC2N 2AX
4	Trinity Road, Halifax, West Yorkshire, HX1 2RG
5	The Mound, Edinburgh, EH1 1YZ
6	5th Floor, The Exchange, George’s Dock, IFSC, Dublin 1, Ireland
7	Cawley House, Chester Business Park, Chester, CH4 9FB
8	Suite 6, Rineanna House, Shannon Free Zone, Co. Clare, Ireland
9	1 More London Place, London, SE1 2AF
10	6th Floor, 125 London Wall, London, EC2Y 5AS
11	40a Station Road, Upminster, Essex, RM14 2TR