HBOS plc

Report and Accounts
2013

Member of Lloyds Banking Group

Contents

Strategic report

Principal activities

HBOS plc (the Company) and its subsidiary undertakings (the Group) provide a wide range of banking and financial services through branches and offices in the UK and overseas.

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; loans and capital market products to commercial, corporate and asset finance customers; life, pensions and investment products; general insurance; and private banking and asset management.

Business review

For the year ended 31 December 2013, the Group recorded a profit before tax of £2,994 million compared with a profit before tax in 2012 of £254 million.

Total income increased by £148 million, or 1 per cent, to £11,986 million in 2013 compared with £11,838 million in 2012, comprising a £325 million increase in other income partly offset by a decrease of £177 million in net interest income.

Net interest income was £6,529 million in 2013; a decrease of £177 million, or 3 per cent compared to £6,706 million in 2012. There was a credit of £109 million in 2012 arising from liability management gains but no similar item in 2013 and there was an adverse impact of £38 million in 2013 from an increase in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group. After adjusting for these items, net interest income was little changed at £6,567 million in 2013 compared to £6,597 million in 2012 reflecting a decrease in average interest-earning assets across all Divisions, mainly the disposal of assets outside of the Group's risk appetite more than offsetting targeted lending growth, offset by an increase in net interest margin, which resulted from improvements in deposit pricing.

Other income was £325 million, or 6 per cent, higher at £5,457 million in 2013 compared to £5,132 million in 2012. Fee and commission income was £434 million, or 26 per cent, lower at £1,225 million compared to £1,659 million in 2012. Fee and commission expense decreased by £155 million, or 29 per cent, to £381 million compared with £536 million in 2012. The decrease in net fee and commission income largely reflects the deconsolidation of St James's Place from April 2013. Net trading income decreased by £343 million, or 9 per cent, to £3,353 million in 2013 compared to £3,696 million in 2012; this decrease included a reduction of £279 million in gains on policyholder investments held within the insurance business as a result of the impact of strong movements in financial markets during the first quarter of 2013 being more than offset by St James's Place plc having ceased to be a subsidiary in March 2013, this movement was matched by a similar decrease in the related claims expense. Other operating income was £974 million, higher at £1,251 million in 2013 compared to £277 million in 2012. The improvement in part reflects asset sales and 2013 includes the gain of £73 million from the sales of shares in St James's Place.

Insurance claims expense was £288 million, or 10 per cent, lower at £2,697 million in 2013 compared to £2,985 million in 2012, this decrease in claims was matched by a similar movement in net trading income, reflecting the improved performance of policyholder investments in the first quarter of 2013, more than offset by the deconsolidation of St James's Place plc from April 2013.

Operating expenses decreased by £409 million, or 10 per cent to £3,880 million in 2013 compared with £4,289 million in 2012; part of the reason for the decrease being the £239 million reduction in charges for regulatory provisions from £1,039 million in 2012 to £800 million in 2013. In addition, 2012 included a past service pension credit of £258 million but there was no such item in 2013. Staff costs were £191 million, or 13 per cent higher at £1,702 million in 2013 compared with £1,511 million in 2012. Excluding the past service pension credit from 2012, staff costs were £67 million, or 4 per cent, lower at £1,702 million in 2013 compared with £1,769 million in 2012; annual pay rises and an increase in pension costs have been offset by the impact of headcount reductions resulting from business disposals and the Lloyds Banking Group's rationalisation programmes. Premises and equipment costs were £25 million, or 7 per cent, lower at £344 million in 2013 compared with £369 million in 2012. Other expenses (excluding the charges in respect of payment protection insurance and other regulatory provisions of £800 million from 2013 and £1,039 million from 2012) were £357 million, or 32 per cent, lower at £756 million in 2013 compared with £1,113 million in 2012, partly as a result of the deconsolidation of St James's Place plc. Depreciation and amortisation costs were £30 million, or 12 per cent, lower at £227 million in 2013 compared to £257 million in 2012.

Impairment losses decreased by £1,895 million, or 44 per cent, to £2,415 million in 2013 compared with £4,310 million in 2012. Impairment losses in respect of loans and advances to customers were £1,828 million, or 43 per cent, lower at £2,424 million compared with £4,252 million in 2012. The overall performance of the portfolio reflects improving credit quality and improvements in the economic environment. The impairment charge in respect of debt securities classified as loans and receivables was a release of £24 million in 2013 compared to a charge of £17 million in 2012 and the impairment charge in respect of available-for-sale financial assets was £26 million, or 63 per cent, lower at £15 million in 2013 compared to £41 million in 2012.

In 2013, the Group recorded a tax charge of £1,385 million compared to a tax charge of £75 million in 2012. The tax charge in 2013 was £689 million higher than the charge that would arise at the standard UK corporation tax rate of 23.25 per cent; principally as a result of a £408 million charge arising from the change in corporation tax rate and a £348 million write-off of deferred tax assets following the sale of the Group's Australian operations. The tax charge of £75 million in 2012 arose on a profit before tax of £254 million. This tax charge reflected the impact of the UK corporation tax rate reduction to 23 per cent on the net deferred tax asset more than offsetting the benefit of non-taxable items.

Over the course of 2013 the Group has made further progress with its aim of strengthening the balance sheet and reducing risk. Total assets were £25,784 million, or 4 per cent, lower at £557,695 million at 31 December 2013 compared to £583,479 million at 31 December 2012, reflecting the run-down of assets which are outside of the Group's risk-appetite and the sale of St James's Place plc partly offset by increased placings with fellow Lloyds Banking Group undertakings. Debt securities in issue were £20,059 million, or 41 per cent, lower at £29,462 million at 31 December 2013 compared to £49,521 million at the end of 2012. However, amounts due to fellow Lloyds Banking Group undertakings were £43,868 million, or 25 per cent, higher at £220,738 million at 31 December 2013 compared to £176,870 million at the end of 2012 as the Group increases the amount of funding received from the Lloyds Banking Group. The Group no longer has any liabilities arising from non-participating investment contracts (£27,166 million at 31 December 2012).

Future developments

Information about future developments is provided with the Principal risks and uncertainties section below.

Capital position at 31 December 2013

The Group's capital position applying prevailing rates at 31 December 2013 is set out in the following section.

Table 1.1 Capital resources (audited)

Capital resources	At 31 Dec 2013	At 31 Dec 2012[1]
Core tier 1		
Shareholders' equity per balance sheet	**21,835**	24,697
Non-controlling interests per balance sheet	**49**	400
Regulatory adjustments:		
Regulatory adjustments to non-controlling interests	**(49)**	(373)
Defined benefit pension adjustment	**(31)**	(666)
Unrealised reserve on available-for-sale debt securities	**46**	158
Unrealised reserve on available-for-sale equity investments	**(84)**	(33)
Cash flow hedging reserve	**(908)**	(1,237)
	20,858	22,946
Less: deductions from core tier 1		
Goodwill	**(334)**	(847)
Intangible assets	**(95)**	(92)
50 per cent excess of expected losses over impairment provisions	**(152)**	(550)
50 per cent of securitisation positions	**(48)**	(113)
Core tier 1 capital	**20,229**	21,344
Preferred securities[2]	**3,182**	3,004
Less: deductions from tier 1		
50 per cent of material holdings	**(41)**	(3)
Total tier 1 capital	**23,370**	24,345
Tier 2		
Undated subordinated debt	**600**	631
Dated subordinated debt	**5,387**	5,708
Unrealised gains on available-for-sale equity investments provisions	**84**	33
Eligible provisions	**355**	942
Less: deductions from tier 2		
50 per cent excess of expected losses over impairment provisions	**(152)**	(550)
50 per cent of securitisation positions	**(48)**	(113)
50 per cent of material holdings	**(41)**	(3)
Total tier 2 capital	**6,185**	6,648
Supervisory deductions		
Unconsolidated investments – life	**–**	(358)
– general insurance and other	**–**	(65)
Connected lending of a capital nature	**(2,640)**	–
Total supervisory deductions	**(2,640)**	(423)
Total capital resources	**26,915**	30,570

Table 1.2 Risk Weighted Assets and Capital Ratios (unaudited)

Risk-weighted assets	**112,177**	164,052
Core tier 1 capital ratio	**18.0%**	13.0%
Tier 1 capital ratio	**20.8%**	14.8%
Total capital ratio	**24.0%**	18.6%

[1]The 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[2]Covered by existing grandfathering provisions.

As at 31 December 2013, the Group's capital ratios had increased with a total capital ratio on a Basel II basis of 24.0 per cent (compared to 18.6 per cent at 31 December 2012, before restatement for the impact of IAS 19 Revised); a tier 1 capital ratio of 20.8 per cent compared to 14.8 per cent and a core tier 1 ratio of 18.0 per cent compared to 13.0 per cent. During 2013 risk-weighted assets decreased by £51.9 billion to £112.2 billion at 31 December 2013 compared with £164.1 billion at 31 December 2012; this decrease reflected risk-weighted asset reductions across all divisions mainly driven by reductions in assets outside of the Group's risk appetite, and movements in external economic factors.

Principal risks and uncertainties
The most significant risks faced by the Group which could impact on the success of delivering against the Group's long-term strategic objectives are outlined below.

Credit risk
Principal risks
As a provider of credit facilities to personal and commercial customers, together with financial institutions and Sovereigns, any adverse changes in the economic and market environment we operate in, or the credit quality and/or behaviour of our borrowers and counterparties would reduce the value of our assets and increase our write-downs and allowances for impairment losses, adversely impacting profitability.

Mitigating actions
- Credit policy incorporating prudent lending criteria aligned with the Lloyds Banking Group Board approved risk appetite to effectively manage credit risk.
- Clearly defined levels of authority ensure we lend appropriately and responsibly with separation of origination and sanctioning.
- Robust credit processes and controls including well-established committees to ensure distressed and impaired loans are identified, considered and controlled.

Conduct risk
Principal risks
As a major financial services provider we face significant conduct risk, including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customer expectations; and exhibiting behaviours which do not meet market or regulatory standards.

Mitigating actions
- Customer focused conduct strategy implemented to ensure customers are at the heart of everything we do.
- Product approval and review processes and outcome testing supported by conduct management information.
- Clearer customer accountabilities for colleagues, including rewards with customer-centric metrics.
- Learn from past mistakes, including root cause analysis.

Market risk
Principal risks
We face a number of key market risks including interest rate risk across the Banking and Insurance businesses. However, our most significant market risk is from the Defined Benefit Pension Schemes where asset and liability movements impact on our capital position.

Mitigating actions
- A rates hedging programme is in place to reduce liability risk.
- Lloyds Banking Group Board approved pensions risk appetite covering interest rate, credit spreads and equity risks.
- Credit assets are being purchased by the schemes as equities are sold.
- Stress and scenario testing.

Operational risk
Principal risks
We face a number of key operational risks including fraud losses and failings in our customer processes. The availability, resilience and security of our core IT systems is the most significant.

Mitigating actions
- Continually review IT system architecture to ensure systems are resilient, readily available for our customers and secure from cyber attack.
- Implement actions from the Lloyds Banking Group IT resilience review conducted in 2013 to reflect enhanced demands on IT both in terms of customer and regulator expectations.

Funding and liquidity
Principal risks
Our funding and liquidity position is supported by a significant and stable customer deposit base. However, a deterioration in either our or the UK's credit rating or sudden and significant withdrawal of customer deposits could adversely impact our funding and liquidity position.

Mitigating actions
- Hold a large pool of liquid primary assets to meet cash and collateral outflows.
- Maintain a further large pool of secondary assets which can be used to access Central Bank liquidity facilities.
- Stress test the Group's liquidity position against a range of scenarios.

Capital risk
Principal risks
Our future capital position is potentially at risk from adverse financial performance and the introduction of higher capital requirements for distinct risks, sectors or as a consequence of specific UK regulatory requirements.

Mitigating actions
- Close monitoring of actual capital ratios to ensure that we comply with current regulatory capital requirements and are well positioned to meet future requirements.
- Internal stress testing results to evidence sufficient levels of capital adequacy for the Group under various scenarios.
- Lloyds Banking Group can accumulate additional capital in a variety of ways including raising equity via a rights issue or debt exchange and by raising tier 1 and tier 2 capital.

Regulatory risk
Principal risks
Due to the nature of the industry we operate in we have to comply with a complex and demanding regulatory change agenda. Regulatory initiatives we have been working on in 2013 include CRD IV, Mortgage Market Review, Dodd-Frank and Foreign Account Tax Compliance Act 2010. The sanctions for failing to comply far outweigh the costs of implementation.

Mitigating actions

- The Lloyds Banking Group Legal, Regulatory and Mandatory Change Committee ensures we drive forward activity to develop plans for regulatory changes and tracks progress against those plans.
- Continued investment in our people, processes and IT systems is enabling us to meet our regulatory commitments.

State aid

Principal risks

HM Treasury currently holds 32.7 per cent of the Group's share capital. Lloyds Banking Group continues to operate without Government interference in the day-to-day management decisions, however there is a risk that a change in Government priorities could result in the current framework agreement being replaced, leading to interference in the operations of the Group. Failure to meet the EU State Aid commitments arising from this Government support could lead to sanctions.

Mitigating actions

- Most EU State Aid commitments now met with the divestment of the rebranded (TSB) retail banking business outstanding.
- Now progressing the divestment of TSB through an Initial Public Offering, subject to regulatory and European Commission approval, to ensure best value for Lloyds Banking Group shareholders and certainty for our customers and colleagues.
- The divested business, rebranded TSB has operated as a separate business within Lloyds Banking Group since September 2013.

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 note 51 on page 103. Additional information can be found in the annual report of Lloyds Banking Group plc, the Company's ultimate parent, which does not form part of this report.

The 2013 Strategic Report has been approved by the Board of Directors.

On behalf of the Board

Sir Winfried Bischoff
HBOS plc
6 March 2014

Directors' report

Results
The consolidated income statement on page 12 shows a profit attributable to equity shareholders for the year ended 31 December 2013 of £1,602 million.

Post balance sheet events
There have been no material post balance sheet events.

Going concern
The going concern of the Company and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the Directors have considered a number of key dependencies including the continued functioning of the money and capital markets, the reduction in wholesale funding requirements resulting from Lloyds Banking Group's strategy to right-size the balance sheet and the absence of significant and sudden withdrawals of customer deposits. The Directors have also considered projections for the Group's capital and funding position. Having considered these, the Directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Branches, future developments and financial risk management objectives and policies
Information regarding the existence of branches, future developments and financial risk management objectives and policies of the Group, in relation to the use of financial instruments, can be found in the strategic report and is incorporated into this report by reference.

Directors
The names of the Directors of the Company are shown on page 8. Changes to the composition of the Board since 1 January 2013 up to the date of this report are shown in the table below:

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

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

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

Directors' interests
The Directors are also Directors of Lloyds Banking Group plc and their interests in shares in Lloyds Banking Group plc are shown in the report and accounts of that company.

Directors' conflicts of interest
The Board, as permitted by the Company's articles of association, has authorised all potential conflicts of interest that have been declared by individual Directors. Decisions regarding these conflicts of interest could be and were only taken by Directors who had no interest in the matter. In taking the decision, the Directors acted in a way they considered, in good faith, would be most likely to promote the Company's success. The Directors have the ability to impose conditions, if thought appropriate, when granting authorisation. Any authorities given are reviewed periodically, and as considered appropriate, and at least every 15 months. No Director is permitted to vote on any resolution or matter where he or she has an actual or potential conflict of interest.

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

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

Share capital and dividends
Information about share capital and dividends is shown in notes 42 and 46 on pages 71 and 73 and is incorporated into this report by reference.

The Company did not repurchase any of its shares during the year (2012: none). There are no restrictions on the transfer of shares in the Company other than set out in the articles of association and certain restrictions which may from time to time be imposed by law and regulations.

The directors have authority to allot and issue shares in the Company.

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

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

Directors' report

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

To support this aim, Lloyds Banking Group belongs to a number of major UK employment equality campaign groups, including the Business Disability Forum, The Age and Employment Network, Stonewall and Race for Opportunity. Involvement with these organisations enables the Group to identify and implement best practice for staff. The Company, as part of Lloyds Banking Group, has a range of programmes to support colleagues who become disabled or acquire a long-term health condition. These include a workplace adjustment programme to provide physical equipment or changes to the way a job is done. The Group also runs residential Personal and Career Development Programmes to help colleagues deal positively with the impact of a disability and the colleague disability network, Access, provides peer support.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group.

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

Significant contracts
Details of related party transactions are set out in note 48 on pages 82 to 85.

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements 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. The Directors are responsible for the maintenance and integrity in relation 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, whose names are shown on page 8 of this annual report, confirms that, to the best of his or her knowledge:

- the financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities and financial position of the Company and Group and the profit or loss of the Group; and
- the management report contained in the strategic report and the directors' report includes a fair review of the development and performance of the business and the position of the Company and Group; together with a description of the principal risks and uncertainties faced by the Company and the Group.

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

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

A resolution will be proposed at the 2014 annual general meeting to reappoint PricewaterhouseCoopers LLP as auditor. The Company's Audit Committee is satisfied that the external auditor remains independent and effective.

On behalf of the Board

Marc Boston
Company Secretary
6 March 2014

HBOS plc
Registered in Scotland
Company Number SC218813

Directors

Sir Winfried Bischoff *Chairman* (retiring 3 April 2014)

A Horta-Osório *Executive Director and Group Chief Executive*

M G Culmer *Executive Director and Chief Financial Officer*

J Colombás *Executive Director and Chief Risk Officer*

Lord Blackwell (Chairman from 3 April 2014)

C J Fairbairn

A M Frew

D John CBE

D L Roberts

N Luff

A Watson CBE

S V Weller

Forward looking statements

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

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

Factors that could cause actual business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's, Lloyds Banking Group plc's or Lloyds Bank plc's credit ratings; the ability to derive cost savings and other benefits including, without limitation, as a result of the Lloyds Banking Group's Simplification Programme; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes; natural and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union (EU), the US or elsewhere; the implementation of the draft EU crisis management framework directive and banking reform, following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; requirements or limitations imposed on Lloyds Banking Group plc, Lloyds Bank plc and the Group as a result of HM Treasury's investment in Lloyds Banking Group plc; the ability to complete satisfactorily the disposal of certain assets as part of Lloyds Banking Group plc's EU State Aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; market related trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and the success of the Group in managing the risks of the foregoing. Please refer to the latest Annual Report of Lloyds Banking Group plc on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors, together with examples of forward looking statements.

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

Independent auditors' report

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HBOS PLC

REPORT ON THE FINANCIAL STATEMENTS

Our opinion

In our opinion:

- The financial statements, defined below, give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2013 and of the Group's profit and of the Group's and Company's cash flows for the year then ended;
- The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- The Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The Group financial statements and Company financial statements (the "financial statements"), which are prepared by HBOS plc, comprise:

- the Group and Company balance sheets as at 31 December 2013;
- the Group income statement and the Group and Company statements of comprehensive income for the year then ended;
- the Group and Company statements of changes in equity and statements of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and, as regards the Company, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Report and Accounts (the "Annual Report") to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

OPINIONS ON MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

OTHER MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Independent auditors' report

RESPONSIBILITIES FOR THE FINANCIAL STATEMENT AUDIT

Our responsibilities and those of the directors

As explained more fully in the Directors' Responsibilities Statement set out on page 7, the directors are responsible for the preparation of the Group and Company financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Group and Company financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Philip Rivett (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
6 March 2014

Notes:

a) The maintenance and integrity of the Lloyds Banking Group plc website is the responsibility of the Group directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

for the year ended 31 December 2013

	Note	2013 £ million	2012[1] £ million
Interest and similar income		**13,696**	15,384
Interest and similar expense		**(7,167)**	(8,678)
Net interest income	5	**6,529**	6,706
Fee and commission income		**1,225**	1,659
Fee and commission expense		**(381)**	(536)
Net fee and commission income	6	**844**	1,123
Net trading income	7	**3,353**	3,696
Insurance premium income	8	**9**	36
Other operating income	9	**1,251**	277
Other income		**5,457**	5,132
Total income		**11,986**	11,838
Insurance claims	10	**(2,697)**	(2,985)
Total income, net of insurance claims		**9,289**	8,853
Regulatory provisions		**(800)**	(1,039)
Other operating expenses		**(3,080)**	(3,250)
Total operating expenses	11	**(3,880)**	(4,289)
Trading surplus		**5,409**	4,564
Impairment	12	**(2,415)**	(4,310)
Profit before tax		**2,994**	254
Taxation	14	**(1,385)**	(75)
Profit for the year		**1,609**	179
Profit attributable to non-controlling interests		**7**	41
Profit attributable to equity shareholders		**1,602**	138
Profit for the year		**1,609**	179

[1]Restated – see note 1.

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

Consolidated statement of comprehensive income

for the year ended 31 December 2013

The Group	2013 £ million	2012[1] £ million
Profit for the year	**1,609**	179
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before taxation	**(831)**	(738)
Taxation	**166**	170
	(665)	(568)
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	**219**	484
Income statement transfers in respect of disposals	**4**	(385)
Income statement transfers in respect of impairment	**45**	397
Taxation	**(105)**	(123)
	163	373
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**(79)**	730
Net income statement transfers	**(394)**	(269)
Taxation	**143**	(83)
	(330)	378
Currency translation differences (tax: nil)	**(115)**	47
Other comprehensive income for the year, net of tax	**(947)**	230
Total comprehensive income for the year	**662**	409
Total comprehensive income attributable to non-controlling interests	**7**	41
Total comprehensive income attributable to equity shareholders	**655**	368
Total comprehensive income for the year	**662**	409

The Company	2013 £ million	2012[1] £ million
Profit (loss) for the year	**1,287**	1,242
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before taxation	**(831)**	(707)
Taxation	**166**	163
	(665)	(544)
Items that may subsequently be reclassified to profit or loss:		
Movements in cash flow hedging reserve:		
Net income statement transfers (tax: nil)	**–**	–
Other comprehensive income for the year, net of tax	**(665)**	(544)
Total comprehensive income for the year	**622**	698

[1]Restated – see note 1.

Consolidated balance sheet

at 31 December 2013

	Note	**2013 £ million**	2012[1] £ million	1 January 2012[1] £ million
Assets				
Cash and balances at central banks		**7,369**	6,112	3,075
Items in the course of collection from banks		**217**	416	379
Trading and other financial assets at fair value through profit or loss	15	**37,317**	63,671	46,255
Derivative financial instruments	16	**20,891**	35,855	36,253
Loans and receivables:				
Loans and advances to banks	17	**2,100**	4,874	5,458
Loans and advances to customers	18	**283,638**	303,622	345,412
Debt securities	21	**529**	3,813	11,276
Due from fellow Lloyds Banking Group undertakings		**193,874**	145,247	97,498
		480,141	457,556	459,644
Available-for-sale financial assets	23	**3,333**	6,052	10,498
Investment properties	24	**626**	1,279	1,686
Goodwill	26	**334**	859	859
Value of in-force business	27	**–**	135	147
Other intangible assets	28	**95**	103	76
Tangible fixed assets	29	**1,415**	1,705	2,372
Current tax recoverable		**2**	576	338
Deferred tax assets	39	**2,748**	3,495	3,846
Retirement benefit assets	38	**39**	733	973
Other assets	30	**3,168**	4,932	3,031
Total assets		**557,695**	583,479	569,432

[1]Restated – see note 1.

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

Consolidated balance sheet

at 31 December 2013

	Note	**2013 £ million**	2012[1] £ million	At 1 January 2012[1] £ million
Equity and liabilities				
Liabilities				
Deposits from banks	31	**3,175**	7,114	5,540
Customer deposits	32	**206,568**	205,269	200,588
Due to fellow Lloyds Banking Group undertakings		**220,738**	176,870	160,962
Items in course of transmission to banks		**262**	518	332
Trading and other financial liabilities at fair value through profit or loss	33	**36,624**	33,610	20,805
Derivative financial instruments	16	**19,137**	31,710	33,385
Notes in circulation		**1,176**	1,198	1,145
Debt securities in issue	34	**29,462**	49,521	75,457
Liabilities arising from insurance contracts and participating investment contracts	35	**–**	423	385
Liabilities arising from non-participating investment contracts	36	**–**	27,166	22,207
Other liabilities	37	**5,241**	11,180	9,169
Retirement benefit obligations	38	**280**	195	164
Current tax liabilities		**766**	58	54
Deferred tax liabilities	39	**–**	69	1
Other provisions	40	**1,404**	1,157	1,064
Subordinated liabilities	41	**10,978**	12,491	13,613
Total liabilities		**535,811**	558,549	544,871
Equity				
Share capital	42	**3,763**	3,763	3,763
Share premium account	43	**18,655**	18,655	18,655
Other reserves	44	**11,039**	11,321	10,523
Retained profits	45	**(11,622)**	(9,209)	(8,779)
Shareholders' equity		**21,835**	24,530	24,162
Non-controlling interests		**49**	400	399
Total equity		**21,884**	24,930	24,561
Total equity and liabilities		**557,695**	583,479	569,432

[1]Restated – see note 1.

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

The directors approved the consolidated financial statements on 6 March 2014.

Sir Winfried Bischoff
Chairman

António Horta-Osório
Chief Executive

George Culmer
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 December 2013

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2012						
As previously reported	22,418	10,523	(9,170)	23,771	399	24,170
Restatement (notes 1 and 54)	–	–	391	391	–	391
Restated	22,418	10,523	(8,779)	24,162	399	24,561
Comprehensive income						
Profit for the year	–	–	138	138	41	179
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(568)	(568)	–	(568)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	373	–	373	–	373
Movements in cash flow hedging reserve, net of tax	–	378	–	378	–	378
Currency translation differences, net of tax	–	47	–	47	–	47
Total other comprehensive income	–	798	(568)	230	–	230
Total comprehensive income	–	798	(430)	368	41	409
Transactions with owners						
Dividends paid	–	–	–	–	(22)	(22)
Change in non-controlling interests	–	–	–	–	(18)	(18)
Total transactions with owners	–	–	–	–	(40)	(40)
Balance at 31 December 2012[1]	22,418	11,321	(9,209)	24,530	400	24,930
Comprehensive income						
Profit for the year	**–**	**–**	**1,602**	**1,602**	**7**	**1,609**
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**(665)**	**(665)**	**–**	**(665)**
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	**–**	**163**	**–**	**163**	**–**	**163**
Movements in cash flow hedging reserve, net of tax	**–**	**(330)**	**–**	**(330)**	**–**	**(330)**
Currency translation differences, net of tax	**–**	**(115)**	**–**	**(115)**	**–**	**(115)**
Total other comprehensive income	**–**	**(282)**	**(665)**	**(947)**	**–**	**(947)**
Total comprehensive income	**–**	**(282)**	**937**	**655**	**7**	**662**
Transactions with owners						
Dividends paid	**–**	**–**	**(3,493)**	**(3,493)**	**–**	**(3,493)**
Value of employee services	**–**	**–**	**143**	**143**	**–**	**143**
Change in non-controlling interests	**–**	**–**	**–**	**–**	**(358)**	**(358)**
Total transactions with owners	**–**	**–**	**(3,350)**	**(3,350)**	**(358)**	**(3,708)**
Balance at 31 December 2013	**22,418**	**11,039**	**(11,622)**	**21,835**	**49**	**21,884**

[1]Restated – see note 1.

Further details of movements in the Group's share capital and reserves are provided in notes 42, 43, 44 and 45.

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

Consolidated cash flow statement

for the year ended 31 December 2013

	Note	2013 £ million	2012[1] £ million
Profit (loss) before tax		**2,994**	254
Adjustments for:			
Change in operating assets	53(a)	**(20,894)**	(11,819)
Change in operating liabilities	53(b)	**21,571**	14,695
Non-cash and other items	53(c)	**(5,701)**	(4,696)
Tax received		**959**	33
Net cash used in operating activities		**(1,071)**	(1,533)
Cash flows from investing activities			
Purchase of available-for-sale financial assets		**(2,354)**	(2,083)
Proceeds from sale and maturity of available-for-sale financial assets		**5,246**	6,759
Purchase of fixed assets		**(240)**	(476)
Proceeds from sale of fixed assets		**1,026**	1,372
Acquisition of businesses, net of cash acquired		**(6)**	(11)
Disposal of businesses, net of cash disposed	53(e)	**1,050**	37
Net cash provided by investing activities		**4,722**	5,598
Cash flows from financing activities			
Dividends paid to non-controlling interests		**(3,493)**	(22)
Interest paid on subordinated liabilities		**(601)**	(697)
Repayment of subordinated liabilities		**(960)**	(649)
Change in stake of non-controlling interests		**–**	20
Net cash used in financing activities		**(5,054)**	(1,348)
Effects of exchange rate changes on cash and cash equivalents		**(7)**	(2)
Change in cash and cash equivalents		**(1,410)**	2,715
Cash and cash equivalents at beginning of year		**9,357**	6,642
Cash and cash equivalents at end of year	53(d)	**7,947**	9,357

[1]Restated – see note 1.

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

Company balance sheet

at 31 December 2013

	Note	**2013 £ million**	2012[1] £ million	At 1 January 2012[1] £ million
Assets				
Amounts owed by Group entities		**33,790**	42,713	47,378
Derivative financial instruments	16	**1,213**	1,565	1,857
Retirement benefit assets	38	**39**	733	973
Deferred tax assets	39	**12**	–	–
Other assets	30	**14**	17	17
Investments in subsidiary undertakings	25	**22,086**	23,000	23,000
Total assets		**57,154**	68,028	73,225
Liabilities				
Amounts owed to Group entities		**22,694**	29,643	35,237
Derivative financial instruments	16	**4**	10	10
Other liabilities	37	**503**	469	457
Current tax liabilities		**86**	307	283
Retirement benefit obligations	38	**235**	141	130
Deferred tax liabilities	39	**–**	175	226
Subordinated liabilities	41	**8,241**	9,021	9,318
Total liabilities		**31,763**	39,766	45,661
Equity				
Issued share capital	42	**3,763**	3,763	3,763
Share premium account	43	**18,655**	18,655	18,655
Other reserves	44	**9,693**	9,693	9,693
Retained profits	45	**(6,720)**	(3,849)	(4,547)
Shareholders' equity		**25,391**	28,262	27,564
Total equity and liabilities		**57,154**	68,028	73,225

[1]Restated – see note 1.

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

Approved by the Board on 6 March 2014 and signed on its behalf by:

Sir Winfried Bischoff
Chairman

António Horta-Osório
Chief Executive

George Culmer
Chief Financial Officer

Company statement of changes in equity

for the year ended 31 December 2013

	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million
Balance at 1 January 2012				
As previously reported	22,418	9,693	(4,978)	27,133
Restatement (notes 1 and 54)	–	–	431	431
Restated	22,418	9,693	(4,547)	27,564
Comprehensive income				
Profit for the year	–	–	1,242	1,242
Other comprehensive income				
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(544)	(544)
Total comprehensive income	–	–	698	698
Balance at 31 December 2012[1]	22,418	9,693	(3,849)	28,262
Comprehensive income				
Profit for the year	**–**	**–**	**1,287**	**1,287**
Other comprehensive income				
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**(665)**	**(665)**
Total comprehensive income	**–**	**–**	**622**	**622**
Transactions with owners				
Dividends paid	**–**	**–**	**(3,493)**	**(3,493)**
Transactions with owners	**–**	**–**	**(3,493)**	**(3,493)**
Balance at 31 December 2013	**22,418**	**9,693**	**(6,720)**	**25,391**

[1]Restated – see note 1.

There were no transactions with owners in 2012.

Company cash flow statement

for the year ended 31 December 2013

	2013 £ million	2012[1] £ million
Profit before tax	**1,317**	1,380
Adjustments for:		
Dividend income	**–**	(202)
Change in operating assets	**5,425**	1,257
Change in operating liabilities	**(6,820)**	(5,579)
Non-cash and other items	**(514)**	162
Tax paid	**(274)**	(1)
Net cash used in operating activities	**(866)**	(2,983)
Cash flows from investing activities		
Disposal of businesses, net of cash disposed	**593**	–
Net cash provided by investing activities	**593**	–
Cash flows from financing activities		
Dividends received from subsidiaries	**–**	202
Dividends paid	**(3,493)**	**–**
Repayment of subordinated liabilities	**(677)**	–
Interest paid on subordinated liabilities	**(418)**	(455)
Net cash used in financing activities	**(4,588)**	(253)
Change in cash and cash equivalents	**(4,861)**	(3,236)
Cash and cash equivalents at beginning of year	**22,327**	25,563
Cash and cash equivalents at end of year	**17,466**	22,327

[1]Restated – see note 1.

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

Notes to the accounts

1 Basis of preparation

The financial statements of HBOS plc have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor body. The EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB. The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

The going concern of the Company and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies which are set out in the Principal risks and uncertainties section under Funding and Liquidity on page 4 and additionally have considered projections for the Group's capital and funding position. Taking all of these factors into account, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2013:

Changes in accounting policy

(i) IFRS 10 *Consolidated Financial Statements*
IFRS 10 supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* and establishes the principles for when the Group controls another entity and is therefore required to consolidate the other entity in the Group's financial statements. Under IFRS 10, the Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power. As a result, the Group consolidates certain entities that were not previously consolidated and no longer consolidates certain entities which were previously consolidated, principally in relation to Open Ended Investment Companies. The Group has applied IFRS 10 retrospectively and restated its comparatives in accordance with the transitional provisions included in the standard. These provisions require the Group to re-assess its control conclusions as at 1 January 2013 and restate its comparative information, applying the revised assessment in 2012 to the extent that the relevant investments were held in that year. Details of the impact of these restatements are provided in note 54 to the financial statements.

(ii) Revised IAS 19 *Employee Benefits* (IAS 19R)
IAS 19R prescribes the accounting and disclosure by employers for employee benefits. Actuarial gains and losses (remeasurements) arising from the valuation of defined benefit pension schemes are no longer permitted to be deferred using the corridor approach and must be recognised immediately in other comprehensive income. In addition, IAS 19R also replaces interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset). IAS 19R has been applied retrospectively and comparative figures restated accordingly. Details of the impact of these restatements are provided in note 54 to the financial statements.

The impact of the implementation of IAS 19R on the Group's results for the year ended 31 December 2013 has been to increase other operating expenses by £1 million and reduce profit before tax by the same amount. The impact on the balance sheet at 31 December 2013 has been to increase the net retirement benefit liability by £1,048 million, to increase deferred tax assets by £210 million and to reduce shareholders' equity by £838 million.

(iii) IFRS 13 *Fair Value Measurement*
IFRS 13 has been applied with effect from 1 January 2013. IFRS 13 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. IFRS 13 requires that the fair value of a non-financial asset is determined based on the highest and best use of the asset, and that the fair value of a liability reflects its non-performance risk. These changes had no significant impact on the measurement of the Group's assets and liabilities. The IFRS 13 disclosures are given in notes 50 (financial instruments) and 24 (investment properties).

Other presentation and disclosure changes
In addition to the accounting policy changes discussed above, on 1 January 2013 the Group adopted the following new standards and amendments to standards which impact the presentation and disclosures in these financial statements; none of these standards has had a material impact on the primary financial statements.

- Amendments to IAS 1 *Presentation of Financial Statements – 'Presentation of Items of Other Comprehensive Income'*
  The amendments to IAS 1 require entities to group items presented in other comprehensive income on the basis of whether they may potentially be reclassified to profit or loss subsequently. The statement of other comprehensive income in these financial statements has been revised to reflect the new requirements.
- Amendments to IFRS 7 *Financial Instruments: Disclosures – 'Disclosures - Offsetting Financial Assets and Financial Liabilities'*
  The amendments to IFRS 7 require entities to disclose information to enable users of the financial statements to evaluate the effect or potential effect of netting arrangements on the balance sheet. These disclosures are given in note 50 to the financial statements.
- IFRS 12 *Disclosure of Interests in Other Entities*
  IFRS 12 requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. These disclosures are made in the notes to these financial statements.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2013 and which have not been applied in preparing these financial statements are given in note 55.

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, joint ventures and associates.

(1) Subsidiaries
Subsidiaries are entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through the exercise of its power. This generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to any of the above elements. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Details of the principal subsidiaries are given in note 25.

The Group consolidates collective investment vehicles if its beneficial ownership interests give it substantive rights to remove the external fund manager over the investment activities of the fund. Where a subsidiary of the Group is the fund manager of a collective investment vehicle, the Group considers a number of factors in determining whether it acts as principal and therefore controls the collective investment vehicle including: an assessment of the scope of the Group's decision making authority over the investment vehicle; the rights held by other parties including substantive removal rights without cause over the Group acting as fund manager; the remuneration to which the Group is entitled in its capacity as decision maker; and the Group's exposure to variable returns from the beneficial interest it holds in the investment vehicle. Consolidation may be appropriate in circumstances where the Group has less than a majority beneficial interest. Where a collective investment vehicle is consolidated the interests of parties other than the Group are reported in other liabilities.

Structured entities, previously referred to as special purpose entities (SPEs), 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 2e(4)) or share capital (see 2r(1)). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

(2) Joint ventures and associates
Joint ventures are entities over which the Group has joint control under a contractual arrangement with other parties. Associates are entities over which the Group has significant influence, but not control or joint control, over the financial and operating policies. Significant influence is the power to participate in the financial and operating policy decisions of the entity and is normally achieved through holding between 20 per cent and 50 per cent of the voting share capital of the entity.

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated at initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Group's share of the post-acquisition results of the joint venture or associate based on audited accounts which are coterminous with the Group or made up to a date which is not more than three months before the Group's reporting date. The share of any losses is restricted to a level that reflects an obligation to fund such losses.

b Goodwill
Goodwill arises on business combinations, including the acquisition of subsidiaries, and on the acquisition of interests in joint ventures and associates; goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired. Where the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities of the acquired entity is greater than the cost of acquisition, the excess is recognised immediately in the income statement.

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. Goodwill arising on acquisitions of associates and joint ventures is included in the Group's investment in joint ventures and associates. At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal except where it has been written off directly to reserves in the past.

c Other intangible assets
Other intangible assets include brands and both internally and externally generated capitalised software enhancements. Intangible assets which have been determined to have a finite useful life are amortised on a straight line basis over their estimated useful life as follows:

Capitalised software enhancements	up to 7 years
Brands (which have been assessed as having finite lives)	10-15 years

Intangible assets with finite useful lives are reviewed at each reporting date to assess whether there is any indication that they are impaired. If any such indication exists the recoverable amount of the asset is determined and in the event that the asset's carrying amount is greater than its recoverable amount, it is written down immediately. Certain brands have been determined to have an indefinite useful life and are not amortised. Such intangible assets are reassessed annually to reconfirm that an indefinite useful life remains appropriate. In the event that an indefinite life is inappropriate a finite life is determined and an impairment review is performed on the asset.

2 Accounting policies (continued)

d Revenue recognition
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability by estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Group including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see h below).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan once drawn. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to life insurance and general insurance business are detailed below (see o below); those relating to leases are set out in k(2) below.

e Financial assets and liabilities
On initial recognition, financial assets are classified into fair value through profit or loss, available-for-sale financial assets, held-to-maturity investments or loans and receivables. Financial liabilities are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value. The Group initially recognises loans and receivables, deposits, debt securities in issue and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of securities and other financial assets and trading liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either:

– substantially all of the risks and rewards of ownership have been transferred; or
– the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when they are extinguished (ie when the obligation is discharged), cancelled or expire.

(1) Financial instruments at fair value through profit or loss
Financial instruments are classified at fair value through profit or loss where they are trading securities or where they are designated at fair value through profit or loss by management. Derivatives are carried at fair value (see f below).

Trading securities are debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains. Such securities are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur. Financial assets and liabilities are designated at fair value through profit or loss on acquisition in the following circumstances:

– it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on different bases. The main type of financial assets designated by the Group at fair value through profit or loss are assets backing insurance contracts and investment contracts issued by the Group's life insurance businesses. Fair value designation allows changes in the fair value of these assets to be recorded in the income statement along with the changes in the value of the associated liabilities, thereby significantly reducing the measurement inconsistency had the assets been classified as available-for-sale financial assets.
– the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, with management information also prepared on this basis. As noted in a(2) above, certain of the Group's investments are managed as venture capital investments and evaluated on the basis of their fair value and these assets are designated at fair value through profit or loss.
– where the assets and liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Refer to note 3 (Critical accounting estimates and judgements: Fair value of financial instruments) and note 50(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

2 Accounting policies (continued)

The Group is permitted to reclassify, at fair value at the date of transfer, non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the trading category if they are no longer held for the purpose of being sold or repurchased in the near term, as follows:

- if the financial assets would have met the definition of loans and receivables (but for the fact that they had to be classified as held for trading at initial recognition), they may be reclassified into loans and receivables where the Group has the intention and ability to hold the assets for the foreseeable future or until maturity; or
- if the financial assets would not have met the definition of loans and receivables, they may be reclassified out of the held for trading category into available-for-sale financial assets in 'rare circumstances'.

(2) Available-for-sale financial assets
Debt securities and equity shares that are not classified as trading securities, at fair value through profit or loss or as loans and receivables are classified as available-for-sale financial assets and are recognised in the balance sheet at their fair value, inclusive of transaction costs. Available-for-sale financial assets are those intended to be held for an indeterminate period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in other comprehensive income, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. Interest calculated using the effective interest method and foreign exchange gains and losses on debt securities denominated in foreign currencies are recognised in the income statement.

The Group is permitted to transfer a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. Reclassification of a financial asset from the available-for-sale category to the held-to-maturity category is permitted when the Group has the ability and intent to hold that financial asset to maturity.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable. Effective interest rates for financial assets reclassified to the loans and receivables and held-to-maturity categories are determined at the reclassification date. Any previous gain or loss on a transferred asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest method or until the asset becomes impaired. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest method.

When an impairment loss is recognised in respect of available-for-sale assets transferred, the unamortised balance of any available-for-sale reserve that remains in equity is transferred to the income statement and recorded as part of the impairment loss.

(3) Loans and receivables
Loans and receivables include loans and advances to banks and customers and eligible assets including those transferred into this category out of the fair value through profit or loss or available-for-sale financial assets categories. Loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs or, for eligible assets transferred into this category, their fair value at the date of transfer. Financial assets classified as loans and receivables are accounted for at amortised cost using the effective interest method (see d above) less provision for impairment (see h below).

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. In cases where the securitisation vehicles are funded by the issue of debt, on terms whereby the majority of the risks and rewards of the portfolio of securitised lending are retained by the Group, these loans and advances continue to be recognised by the Group, together with a corresponding liability for the funding.

(4) Borrowings
Borrowings (which include deposits from banks, customer deposits, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

An exchange of financial liabilities on substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The difference between the carrying amount of a financial liability extinguished and the new financial liability is recognised in profit or loss together with any related costs or fees incurred.

When a financial liability is exchanged for an equity instrument, the new equity instrument is recognised at fair value and any difference between the original carrying value of the liability and the fair value of the new equity is recognised in the profit or loss together with any related costs or fees incurred.

(5) Sale and repurchase agreements
Securities sold subject to repurchase agreements (repos) continue to be recognised on the balance sheet where substantially all of the risks and rewards are retained. Funds received under these arrangements are included in deposits from banks, customer deposits, or trading liabilities. Conversely, securities purchased under agreements to resell (reverse repos), where the Group does not acquire substantially all of the risks and rewards of ownership, are recorded as loans and receivables or trading securities. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Securities borrowing and lending transactions are typically secured; collateral takes the form of securities or cash advanced or received. Securities lent to counterparties are retained on the balance sheet. Securities borrowed are not recognised on the balance sheet, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability. Cash collateral given or received is treated as a loan and receivable or customer deposit.

f Derivative financial instruments and hedge accounting
All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and option pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 3 (Critical accounting estimates and judgements: Fair value of financial instruments) and note 50(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

2 Accounting policies (continued)

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. In accordance with IFRS 4 Insurance Contracts, a policyholder's option to surrender an insurance contract for a fixed amount is not treated as an embedded derivative.

The method of recognising the movements in the fair value of derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item and the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship is tested both at inception and throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

The Group designates certain derivatives as either: (1) hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges); (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges); or (3) hedges of net investments in foreign operations (net investment hedges). These are accounted for as follows:

(1) Fair value hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk; this also applies if the hedged asset is classified as an available-for-sale financial asset. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity.

(2) Cash flow hedges
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income in the cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(3) Net investment hedges
Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income, the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of. The hedging instruments used in net investment hedges may include non-derivative liabilities as well as derivative financial instruments.

g Offset
Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

h Impairment of financial assets
(1) Assets accounted for at amortised cost
At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition of the financial asset and prior to the balance sheet date, there is objective evidence that a financial asset or group of financial assets has become impaired.

Where such an event has had an impact on the estimated future cash flows of the financial asset or group of financial assets, an impairment allowance is recognised. The amount of impairment allowance is the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If the asset has a variable rate of interest, the discount rate used for measuring the impairment allowance is the current effective interest rate.

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an effective interest rate basis, on the asset's carrying value net of impairment provisions. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

Impairment allowances are assessed individually for financial assets that are individually significant. Such individual assessment is used primarily for the Group's wholesale lending portfolios. Impairment allowances for portfolios of smaller balance homogenous loans such as most residential mortgages, personal loans and credit card balances in the Group's retail portfolios that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis.

Individual assessment
In respect of individually significant financial assets in the Group's wholesale lending portfolios, assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed on a watch list where greater monitoring is undertaken and any adverse or potentially adverse impact on ability to repay is used in assessing whether an asset should be transferred to a dedicated Business Support Unit. Specific examples of trigger events that would lead to the initial recognition of impairment allowances against lending to corporate borrowers (or the recognition of additional impairment allowances) include (i) trading losses, loss of business or major customer of a borrower; (ii) material breaches of the terms and conditions of a loan facility, including non-payment of interest or principal, or a fall in the value of security such that it is no longer considered adequate; (iii) disappearance of an active market because of financial difficulties; or (iv) restructuring a facility with preferential terms to aid recovery of the lending (such as a debt for equity swap).

2 Accounting policies (continued)

For such individually identified financial assets, a review is undertaken of the expected future cash flows which requires significant management judgement as to the amount and timing of such cash flows. Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of costs to realise, whether or not foreclosure or realisation of the collateral is probable.

For impaired debt instruments which are held at amortised cost, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows. A reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment.

Collective assessment

Impairment is assessed on a collective basis for (1) homogenous groups of loans that are not considered individually impaired; and (2) to cover losses which have been incurred but have not yet been identified on loans subject to individual impairment.

Homogenous groups of loans

In respect of portfolios of smaller balance, homogenous loans, or otherwise where there is no objective evidence of individual impairment, the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors, such as the type of asset, industry sector, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Generally, the impairment trigger used within the impairment calculation for a loan, or group of loans, is when they reach a pre-defined level of delinquency or where the customer is bankrupt. Loans where the Group provides arrangements that forgive a portion of interest or principal are also deemed to be impaired and loans that are originated to refinance currently impaired assets are also defined as impaired.

In respect of the Group's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those six months or more in arrears (or certain cases where the borrower is bankrupt or is in possession). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. Historical loss experience is adjusted on the basis of current observable data about economic and credit conditions (including unemployment rates and borrowers' behaviour) to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

Incurred but not yet identified impairment

The collective provision also includes provision for inherent losses, that is losses that have been incurred but have not been separately identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. Risk drivers for secured retail lending include the current indexed loan-to-value, previous mortgage arrears, internal cross-product delinquency data and external credit bureau data; for unsecured retail lending they include whether the account is up-to-date and, if not, the number of payments that have been missed; and for wholesale lending they include factors such as observed default rates and loss given default. An assessment is made of the likelihood of each account becoming recognised as impaired within the loss emergence period, with the economic loss that each portfolio is likely to generate were it to become impaired. The loss emergence period is determined by local management for each portfolio and the Group has a range of loss emergence periods which are dependent upon the characteristics of the portfolios. Emergence periods are reviewed regularly and updated when appropriate. In general the periods used across the Group vary between one month and twelve months based on historical experience. Unsecured portfolios tend to have shorter loss emergence periods than secured portfolios.

Loan renegotiations and forbearance

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with the revised terms. Renegotiation may lead to the loan and associated provision being derecognised and a new loan being recognised initially at fair value.

Write offs

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement. For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes has been completed, or the status of the account reaches a point where policy dictates that forbearance is no longer appropriate. For wholesale lending, a write-off occurs if the loan facility with the customer is restructured, the asset is under administration and the only monies that can be received are the amounts estimated by the administrator, the underlying assets are disposed and a decision is made that no further settlement monies will be received, or external evidence (for example, third party valuations) is available that there has been an irreversible decline in expected cash flows.

Debt for equity exchanges

Equity securities acquired in exchange for loans in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of equity securities, held as available-for-sale. Where control is obtained over an entity as a result of the transaction, the entity is consolidated; where the Group has significant influence over an entity as a result of the transaction, the investment is accounted for by the equity method of accounting (see a above). Any subsequent impairment of the assets or business acquired is treated as an impairment of the relevant asset or business and not as an impairment of the original instrument.

(2) Available-for-sale financial assets

The Group assesses, at each balance sheet date, whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer, assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether

2 Accounting policies (continued)

there has been a significant or prolonged decline in the fair value of the asset below its cost. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised, is reclassified from equity to the income statement. For impaired debt instruments, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows; although a reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to other comprehensive income. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

i Investment property
Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital appreciation or both. The Group's investment property primarily relates to property held for long-term rental yields and capital appreciation within the life insurance funds. Investment property is carried in the balance sheet at fair value, being the open market value as determined in accordance with the guidance published by the Royal Institution of Chartered Surveyors. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair value are recognised in the income statement as net trading income.

j Tangible fixed assets
Tangible fixed assets are included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

- Freehold/long and short leasehold premises: shorter of 50 years and the remaining period of the lease.
- Leasehold improvements: shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease.

Equipment:

- Fixtures and furnishings: 10-20 years.
- Other equipment and motor vehicles: 2-8 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

k Leases
(1) As lessee
The leases entered into by the Group are primarily operating leases. Operating lease rentals payable are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

(2) As lessor
Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee but not necessarily legal title. All other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable, net of provisions, within loans and advances to banks and customers. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance lease income. Finance lease income is recognised in interest income over the term of the lease using the net investment method (before tax) so as to give a constant rate of return on the net investment in the leases. Unguaranteed residual values are reviewed regularly to identify any impairment.

Operating lease assets are included within tangible fixed assets at cost and depreciated over their estimated useful lives, which equates to the lives of the leases, after taking into account anticipated residual values. Operating lease rental income is recognised on a straight-line basis over the life of the lease.

The Group evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease which is then accounted for separately.

l Employee benefits
Short-term employee benefits, such as salaries, paid absences, performance-based cash awards and social security costs are recognised over the period in which the employees provide the related services.

The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Group's income statement charge includes the current service cost of providing pension benefits, past service costs, net interest expense (income), and plan administration costs that are not deducted from the return on plan assets. Past service costs, which represents the change in the present value of the defined

2 Accounting policies (continued)

benefit obligation resulting from a plan amendment or curtailment, are recognised when the plan amendment or curtailment occurs. Net interest expense (income) is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset.

Remeasurements, comprising actuarial gains and losses, the return on plan assets (excluding amounts included in net interest expense (income) and net of the cost of managing the plan assets), and the effect of changes to the asset ceiling (if applicable) are reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occur. Remeasurements recognised in other comprehensive income are reflected immediately in retained profits and will not subsequently be reclassified to profit or loss.

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

The accounting for share-based compensation is set out in (m) below.

m 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. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model or a Monte Carlo simulation. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement, together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement.

n Taxation
Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term insurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on shareholders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred and current tax related to gains and losses on the fair value re-measurement of available-for-sale investments and cash flow hedges, where these gains and losses are recognised in other comprehensive income, is also recognised in other comprehensive income. Such tax is subsequently transferred to the income statement together with the gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

o Insurance
The Group undertakes both life insurance and general insurance business. Insurance and participating investment contracts are accounted for under IFRS 4 *Insurance Contracts,* which permits (with certain exceptions) the continuation of accounting practices for measuring insurance and participating investment contracts that applied prior to the adoption of IFRS. The Group, therefore, continues to account for these products using UK GAAP, including FRS 27 *Life Assurance* and UK established practice.

Products sold by the life insurance business are classified into three categories:

– Insurance contracts – these contracts transfer significant insurance risk and may also transfer financial risk. The Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. These contracts may or may not include discretionary participation features.
– Investment contracts containing a discretionary participation feature ('participating investment contracts') – these contracts do not transfer significant insurance risk, but contain a contractual right which gives the holder the right to receive, in addition to the guaranteed benefits, further additional discretionary benefits or bonuses that are likely to be a significant proportion of the total contractual benefits and the amount and timing of which is at the discretion of the Group, within the constraints of the terms and conditions of the instrument and based upon the performance of specified assets.
– Non-participating investment contracts – these contracts do not transfer significant insurance risk or contain a discretionary participation feature.

The general insurance business issues only insurance contracts.

(1) Life insurance business
(i) Accounting for insurance and participating investment contracts
Premiums and claims
Premiums received in respect of insurance and participating investment contracts are recognised as revenue when due except for unit-linked contracts on which premiums are recognised as revenue when received. Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified.

2 Accounting policies (continued)

Liabilities

– Insurance and participating investment contracts in the Group's with-profit funds

Liabilities of the Group's with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in the unallocated surplus (see below). Changes in the value of these liabilities are recognised in the income statement through insurance claims.

– Insurance and participating investment contracts which are not unit-linked or in the Group's with-profit funds

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life insurance and annuity benefits where future mortality is uncertain.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

Changes in the value of these liabilities are recognised in the income statement through insurance claims.

– Insurance and participating investment contracts which are unit-linked

Liabilities for unit-linked insurance contracts and participating investment contracts are stated at the bid value of units plus an additional allowance where appropriate (such as for any excess of future expenses over charges). The liability is increased or reduced by the change in the unit prices and is reduced by policy administration fees, mortality and surrender charges and any withdrawals. Changes in the value of the liability are recognised in the income statement through insurance claims. Benefit claims in excess of the account balances incurred in the period are also charged through insurance claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges.

Unallocated surplus

Any amounts in the with-profit funds not yet determined as being due to policyholders or shareholders are recognised as an unallocated surplus which is shown separately from liabilities arising from insurance contracts and participating investment contracts.

(ii) Accounting for non-participating investment contracts

The Group's non-participating investment contracts are primarily unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable. Investment returns (including movements in fair value and investment income) allocated to those contracts are recognised in insurance claims.

Deposits and withdrawals are not accounted for through the income statement but are accounted for directly in the balance sheet as adjustments to the non-participating investment contract liability.

The Group receives investment management fees in the form of an initial adjustment or charge to the amount invested. These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them over the estimated lives of the contracts, in line with the provision of investment management services.

Costs which are directly attributable and incremental to securing new non-participating investment contracts are deferred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately through fee and commission expense in the income statement. All other costs are recognised as expenses when incurred.

(iii) Value of in-force business

The Group recognises as an asset the value of in-force business in respect of insurance contracts and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined after making appropriate assumptions about future economic and operating conditions such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

The Group's contractual rights to benefits from providing investment management services in relation to non-participating investment contracts acquired in business combinations and portfolio transfers are measured at fair value at the date of acquisition. The resulting asset is amortised over the estimated lives of the contracts. At each reporting date an assessment is made to determine if there is any indication of impairment. Where impairment exists, the carrying value of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement.

(2) General insurance business

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet within liabilities arising from insurance contracts and participating investment contracts and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims liabilities are not discounted.

(3) Liability adequacy test

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities net of related deferred cost assets and value of in-force business. In performing these tests current best estimates of discounted future contractual cash flows and claims handling

2 Accounting policies (continued)

and policy administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the income statement, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from liability adequacy tests.

(4) Reinsurance
Contracts entered into by the Group with reinsurers under which the Group is compensated for benefits payable on one or more contracts issued by the Group are recognised as assets arising from reinsurance contracts held. Where the underlying contracts issued by the Group are classified as insurance contracts and the reinsurance contract transfers significant insurance risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the underlying contracts issued by the Group are classified as non-participating investment contracts and the reinsurance contract transfers financial risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as non-participating investment contracts.

Assets arising from reinsurance contracts held – Classified as insurance contracts
Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. Premiums payable for reinsurance contracts are recognised as an expense when due within insurance premium income. Changes in the reinsurance recoverable assets are recognised in the income statement through insurance claims.

Assets arising from reinsurance contracts held – Classified as non-participating investment contracts
These contracts are accounted for as financial assets whose value is contractually linked to the fair values of financial assets within the reinsurers' investment funds. Investment returns (including movements in fair value and investment income) allocated to these contracts are recognised in insurance claims. Deposits and withdrawals are not accounted for through the income statement but are accounted for directly in the balance sheet as adjustments to the assets arising from reinsurance contracts held.

p Foreign currency translation
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in sterling, which is the Company's functional and presentation currency.

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items held at fair value through profit and loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on available-for-sale non-monetary financial assets, such as equity shares, are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

The results and financial position of all group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

– The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date.
– The income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions.

Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income and accumulated in a separate component of equity together with exchange differences arising from the translation of borrowings and other currency instruments designated as hedges of such investments (see f(3) above). On disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation are reclassified from equity and included in determining the profit or loss arising on disposal.

q Provisions and contingent liabilities
Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Provision is made for irrevocable undrawn loan commitments if it is probable that the facility will be drawn and result in the recognition of an asset at an amount less than the amount advanced.

r Share capital
(1) Share issue costs
Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

(2) Dividends
Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid.

s Cash and cash equivalents
For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

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

3 Critical accounting estimates and judgements

The preparation of the Group's financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the Group's results and financial position, are as follows.

Allowance for impairment losses on loans and receivables
At 31 December 2013 gross loans and receivables totalled £493,146 million (2012: £476,425 million) against which impairment allowances of £13,005 million (2012: £18,869 million) had been made (see note 22). The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2(h); this note also provides an overview of the methodologies applied.

The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. Impairment allowances are made up of two components, those determined individually and those determined collectively.

Individual impairment allowances are generally established against the Group's wholesale lending portfolios. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer, and the value of the security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in the current economic environment in assessing the borrower's cash flows and debt servicing capability together with the realisable value of real estate collateral. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

Collective impairment allowances are generally established for smaller balance homogenous portfolios such as the retail portfolios. The collective impairment allowance is also subject to estimation uncertainty and in particular is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is, however, inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

Given the relative size of the mortgage portfolio, a key variable is house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices were ten per cent lower than those estimated at 31 December 2013, the impairment charge would increase by approximately £275 million in respect of UK mortgages and a further £36 million in respect of Irish mortgages.

In addition, a collective unimpaired provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Group's wholesale businesses, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unimpaired provisions would result in an increase in the collective unimpaired provision of approximately £57 million (at 31 December 2012, a one month increase in the loss emergence period would have increased the collective unimpaired provision by an estimated £88 million).

Recoverability of deferred tax assets
At 31 December 2013 the Group carried deferred tax assets on its balance sheet of £2,748 million (2012: £3,495 million) and deferred tax liabilities of £nil (2012: £69 million) (note 39). This presentation takes into account the ability of the Group to net deferred tax assets and liabilities only where there is a legally enforceable right of offset. Note 39 presents the Group's deferred tax assets and liabilities by type. The largest category of deferred tax asset relates to tax losses carried forward.

The recoverability of the Group's deferred tax assets in respect of carry forward losses is based on an assessment of future levels of taxable profit expected to arise that can be offset against these losses. The Group's expectations as to the level of future taxable profits take into account the Group's long-term financial and strategic plans, and anticipated future tax adjusting items.

In making this assessment account is taken of, business plans, the five year board approved operating plan and the following future risk factors:

- The expected future economic outlook as set out in the Group Chief Executive's Review and Market Overview contained in the Annual Report of Lloyds Banking Group.
- The retail banking business disposal as required by the European Commission; and
- Future regulatory change.

The Group's total deferred tax asset includes £2,855 million (2012: £3,637 million) in respect of trading losses carried forward. All of the unused tax losses for which a deferred tax asset has been recognised arise in Bank of Scotland plc and all those tax losses will be used as future taxable profits arise in that company.

Under current UK tax law there is no expiry date for unused tax losses. However, the losses are still expected to be fully utilised by 2019.

As disclosed in note 39, deferred tax assets totalling £228 million (2012: £664 million) have not been recognised in respect of certain capital losses carried forward, trading losses carried forward (mainly in certain overseas companies) and unrelieved foreign tax credits as there are no predicted future capital or taxable profits against which these losses can be recognised.

Retirement benefit obligations
The net liability recognised in the Group's balance sheet at 31 December 2013 in respect of retirement benefit obligations was £241 million (comprising an asset of £39 million and a liability of £280 million) (2012: a net asset of £538 million comprising an asset of £733 million and a liability of £195 million), related to post-retirement defined benefit schemes. The net liability recognised in the Company's balance sheet at 31 December 2013 in respect of the retirement benefit obligations was £196 million (2012: net asset of £592 million), comprising an asset of £39 million (2012: £733 million) and a liability of £235 million (2012: £141 million) related to post-retirement defined benefit schemes. The defined benefit pension schemes' net accounting deficit for the Group totalled £162 million (2012: net asset value of £617 million), for the Company there was a net accounting deficit of £117 million (2012: surplus of £671 million), representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

3 Critical accounting estimates and judgements (continued)

The value of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The accounting surplus or deficit is sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variation. The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience and extrapolate the improving trend, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience.

The effect on the net accounting surplus or deficit and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions is set out in note 38.

Payment protection insurance and other regulatory provisions
At 31 December 2013, the Group carried provisions of £1,319 million (2012: £1,059 million) against the cost of making redress payments to customers and the related administration costs in connection with historic regulatory breaches, principally the misselling of payment protection insurance. Determining the amount of the provisions, which represent management's best estimate of the cost of settling these issues, requires the exercise of significant judgement. It will often be necessary to form a view on matters which are inherently uncertain, such as the number of future complaints, the extent to which they will be upheld and the average cost of redress. Consequently the continued appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and other relevant evidence and adjustments made to the provisions where appropriate.

Note 40 contains more detail on the nature of the assumptions that have been made and key sensitivities.

Fair value of financial instruments
In accordance with IFRS 7 *Financial Instruments: Disclosure*, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and, in particular, level 3 is determined using valuation techniques including discounted cash flow analysis and valuation models. These valuation techniques involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information.

Valuation techniques for level 2 financial instruments use inputs that are largely based on observable market data. Level 3 financial instruments are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Determining the appropriate assumptions to be used for level 3 financial instruments requires significant management judgement.

At 31 December 2013, the Group classified £945 million of financial assets and £102 million of financial liabilities as level 3. Further details of the Group's level 3 financial instruments and the sensitivity of their valuation including the effect of applying reasonably possible alternative assumptions in determining their fair value are set out in note 50.

4 Segmental analysis

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 this document. 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.

Following the continuing reduction in the Group's non-UK activities, an analysis between UK and non-UK activities is no longer provided.

5 Net interest income

	Weighted average effective interest rate			
	2013 %	2012[1] %	**2013 £m**	2012[1] £m
Interest and similar income:				
Loans and advances to banks and customers	**2.75**	3.06	**13,407**	14,834
Debt securities held as loans and receivables	**7.24**	3.80	**206**	300
Interest receivable on loans and receivables	**2.78**	3.08	**13,613**	15,134
Available-for-sale financial assets	**2.59**	4.34	**83**	250
Total interest and similar income	**2.77**	3.09	**13,696**	15,384
Interest and similar expense:				
Deposits from banks and customer deposits, excluding liabilities under sale and repurchase agreements	**1.56**	1.76	**(6,033)**	(6,597)
Debt securities in issue	**0.25**	1.33	**(102)**	(784)
Subordinated liabilities	**4.83**	4.83	**(587)**	(657)
Liabilities under sale and repurchase agreements	**0.24**	1.70	**(21)**	(50)
Interest payable on liabilities held at amortised cost	**1.50**	1.81	**(6,743)**	(8,088)
Other	**8.11**	14.75	**(424)**	(590)
Total interest and similar expense	**1.58**	1.92	**(7,167)**	(8,678)
Net interest income			**6,529**	6,706

[1]Restated – see note 1.

Included within interest and similar income is £601 million (2012: £889 million) in respect of impaired financial assets. Net interest income also includes a credit of £394 million (2012: a credit of £269 million) transferred from the cash flow hedging reserve (see note 44).

Notes to the accounts

6 Net fee and commission income

	2013 £m	2012 £m
Fee and commission income:		
Current accounts	**284**	281
Credit and debit card fees	**256**	262
Other	**685**	1,116
Total fee and commission income	**1,225**	1,659
Fee and commission expense	**(381)**	(536)
Net fee and commission income	**844**	1,123

As discussed in note 2, fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 5. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 7.

7 Net trading income

	2013 £m	2012[1] £m
Foreign exchange translation (losses) gains	**(20)**	19
(Losses) gains on foreign exchange trading transactions	**(10)**	41
Total foreign exchange	**(30)**	60
Investment property losses (note 24)	**(95)**	(116)
Securities and other gains (see below)	**3,478**	3,752
Net trading income	**3,353**	3,696

[1]Restated – see note 1.

Securities and other gains comprise net gains arising on assets and liabilities held at fair value through profit or loss and for trading as follows:

	2013 £m	2012[1] £m
Net income arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**428**	501
Equity shares	**3,049**	3,061
Total net income arising on assets held at fair value through profit or loss	**3,477**	3,562
Net gains on financial instruments held for trading	**1**	190
Securities and other gains	**3,478**	3,752

[1]Restated – see note 1.

Notes to the accounts

8 Insurance premium income

	2013 £m	2012 £m
Life insurance		
Gross premiums	**16**	61
Ceded reinsurance premiums	**(7)**	(25)
Total net earned premiums	**9**	36

Life insurance gross premiums can be further analysed as follows:

	2013 £m	2012 £m
Life and pensions	**16**	**61**
Annuities	–	–
Other	–	–
Gross premiums	**16**	**61**

9 Other operating income

	2013 £m	2012 £m
Operating lease rental income	**84**	139
Rental income from investment properties (note 24)	**46**	85
Other rents receivable	–	12
(Losses) gains on disposal of available-for-sale financial assets	**(3)**	385
Liability management losses	**(81)**	(40)
Movement in value of in-force business (note 27)	**(9)**	(5)
Share of results of joint ventures and associates (note 13)	**43**	28
Other	**1,171**	(327)
Total other operating income	**1,251**	277

Other

- On 15 March 2013 the Group completed the sale of 102 million shares in St James's Place plc, reducing the Group's holding in that company to approximately 37 per cent. As a result of that reduction in holding, the Group ceased to consolidate St James's Place plc in its accounts, instead accounting for the residual investment as an associate. Subsequently, on 29 May 2013 the Group completed the sale of a further 77 million shares, and on 13 December 2013 completed the sale of the remainder of its holding. Overall, these sales generated a profit of £73 million.
- On 31 December 2013, the Group completed the sale of its Australian operations (which principally comprise Capital Finance Australia Limited, a provider of motor and equipment asset finance, and BOS International (Australia) Limited, a corporate lending business).

10 Insurance claims

Insurance claims comprise:

	2013 £m	2012 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross (see below)	10	48
Reinsurers' share	(4)	(20)
	6	28
Change in insurance and participating investment contracts (note 35):		
Change in gross liabilities	42	38
Change in assets arising from reinsurance contracts held	5	(4)
	47	34
Change in gross non-participating investment contracts:		
Change in gross liabilities	2,644	2,923
Change in assets arising from reinsurance contracts held	–	–
	2,644	2,923
Total life insurance and participating investment contracts	2,697	2,985
Total insurance claims	2,697	2,985

Life insurance and participating investment contract gross claims can also be analysed as follows:

	2013 £m	2012 £m
Deaths	2	10
Maturities	1	7
Surrenders	4	20
Annuities	–	–
Other	3	11
Total life insurance gross claims	10	48

11 Operating expenses

	2013 £m	2012[1] £m
Staff costs:		
Salaries	1,293	1,360
Social security costs	125	128
Pensions and other post-retirement benefit schemes (note 38):		
Past service credits and curtailment gain[2]	–	(258)
Other	218	185
	218	(73)
Restructuring costs	–	–
Other staff costs	66	96
	1,702	1,511
Premises and equipment:		
Rent and rates	182	196
Hire of equipment	1	2
Repairs and maintenance	37	29
Other	124	142
	344	369
Other expenses:		
Communications and data processing	201	245
Advertising and promotion	66	106
Professional fees	11	31
Other	477	731
	755	1,113
Depreciation and amortisation:		
Depreciation of tangible fixed assets (note 29)	211	236
Amortisation of acquired value of in-force non-participating investment contracts (note 27)	2	7
Amortisation of other intangible assets (note 28)	15	14
	228	257
Impairment of goodwill (note 26)	51	–
Total operating expenses, excluding regulatory provisions	3,080	3,250
Regulatory provisions:		
Payment protection insurance provision (note 40)	740	850
Other regulatory provisions[3] (note 40)	60	189
	800	1,039
Total operating expenses	**3,880**	4,289

[1]Restated – see note 1.

[2]During 2012, following a review of policy in respect of discretionary pension increases in relation to the Group's defined benefit pension schemes, increases in certain schemes are now linked to the Consumer Price Index rather than the Retail Price Index. The impact of this change is a reduction in the Group's defined benefit obligation of £258 million, recognised in the Group's income statement in 2012.

[3]Other regulatory provisions in 2013 include a fine of £12 million levied on the Group by the Financial Conduct Authority in relation to failings in control over sales incentive schemes in the Group's branch network.

11 Operating expenses (continued)

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

	2013	2012
UK	41,130	45,716
Overseas	86	1,104
Total	**41,216**	**46,820**

Fees payable to the Company's auditors

During the year the auditors earned the following fees:

	2013 £m	2012 £m
Fees payable for the audit of the Company's current year annual report	0.6	0.6
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	5.1	6.0
Other services supplied pursuant to legislation	0.8	0.7
Other services – audit related fees	–	0.1
Taxation compliance services	–	–
All other taxation advisory services	–	0.1
Services relating to corporate finance transactions	–	–
All other services	–	0.2
Total fees payable to the Company's auditors by the Group	**6.5**	**7.7**

During the year, the auditors also earned fees payable by entities outside the consolidated Group in respect of the following:

	2013 £m	2012 £m
Audits of Group pension schemes	–	0.1
Reviews of the financial position of corporate and other borrowers	0.9	1.3

12 Impairment

	2013 £m	2012 £m
Impairment losses on loans and receivables:		
Loans and advances to customers	2,424	4,252
Debt securities classified as loans and receivables	(24)	17
Total impairment losses on loans and receivables (note 22)	2,400	4,269
Impairment of available-for-sale financial assets	15	41
Other credit risk provisions	–	–
Total impairment charged to the income statement	**2,415**	**4,310**

No impairment allowances have been raised in respect of amounts due from fellow Lloyds Banking Group undertakings.

13 Investments in joint ventures and associates

The Group's share of results of and investments in joint ventures and associates comprises:

	Joint ventures		Associates		Total	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Share of income statement amounts:						
Income	**65**	278	**151**	63	**216**	341
Expenses	**(32)**	(229)	**(116)**	(68)	**(148)**	(297)
Impairment	**(22)**	(6)	**–**	(1)	**(22)**	(7)
Profit (loss) before tax	**11**	43	**35**	(6)	**46**	37
Tax	**(4)**	(9)	**1**	–	**(3)**	(9)
Share of post-tax results	**7**	34	**36**	(6)	**43**	28
Share of other comprehensive income	**–**	6	**–**	–	**–**	6
Share of total comprehensive income	**7**	40	**36**	(6)	**43**	34
Share of balance sheet amounts:						
Current assets	**483**	3,097	**114**	127	**597**	3,224
Non-current assets	**1,158**	1,596	**508**	581	**1,666**	2,177
Current liabilities	**(432)**	(729)	**(249)**	(128)	**(681)**	(857)
Non-current liabilities	**(1,139)**	(3,672)	**(367)**	(566)	**(1,506)**	(4,238)
Share of net assets at 31 December	**70**	292	**6**	14	**76**	306
Movement in investments over the year:						
At 1 January	**292**	305	**14**	25	**306**	330
Additional investments	**4**	10	**957**	1	**961**	11
Disposals	**(218)**	(44)	**(983)**	(6)	**(1,201)**	(50)
Share of post-tax results	**7**	34	**36**	(6)	**43**	28
Dividends paid	**(7)**	(13)	**(18)**	–	**(25)**	(13)
Exchange and other adjustments	**(8)**	–	**–**	–	**(8)**	–
Share of net assets at 31 December	**70**	292	**6**	14	**76**	306

The Group's unrecognised share of losses of associates for the year was £4 million (2012: recognised net loss of £10 million). The Group's unrecognised share of losses of joint ventures was £94 million in 2013 (2012: £126 million). For entities making losses, subsequent profits earned are not recognised until previously unrecognised losses are extinguished. The Group's unrecognised share of losses net of unrecognised profits on a cumulative basis of associates is £36 million (2012: £31 million) and of joint ventures is £358 million (2012: £329 million).

In March 2013 the Group sold a tranche of shares in St James's Place plc, reducing the Group's holding in that company to approximately 37 per cent and from that point commenced accounting for the residual investment as an associate. The Group sold its remaining shareholding in May and December 2013 so that the entire investment had been disposed of by the end of the year.

The Group's principal joint venture investment at 31 December 2013 was in Sainsbury's Bank plc; the Group owns 50 per cent of the ordinary share capital of Sainsbury's Bank plc, whose business is banking and principal area of operation is the UK. Sainsbury's Bank plc is incorporated in the UK and the Group's interest is held by a subsidiary. In May 2013 the Group reached agreement to sell its interest in Sainsbury's Bank plc to J Sainsbury plc; this transaction completed on 31 January 2014 and the Group's investment at 31 December 2013 is included in disposal group assets within other assets (see note 30).

Where entities have statutory accounts drawn up to a date other than 31 December management accounts are used when accounting for them by the Group.

Notes to the accounts

14 Taxation

a Analysis of tax charge for the year

	2013 £m	2012[1] £m
UK corporation tax:		
Current tax on profit for the year	**(123)**	157
Adjustments in respect of prior years	**(218)**	170
	(341)	327
Foreign tax:		
Current tax on profit for the year	**(12)**	(25)
Adjustments in respect of prior years	**6**	(7)
	(6)	(32)
Current tax credit	**(347)**	295
Deferred tax (note 39):		
Origination and reversal of temporary differences	**(866)**	1
Reduction in UK corporation tax rate	**(408)**	(289)
Adjustments in respect of prior years	**236**	(82)
	(1,038)	(370)
Tax charge	**(1,385)**	(75)

The tax charge for 2013 is based on a UK corporation tax rate of 23.25 per cent (2012: 24.5 per cent).

The above income tax charge is made up as follows:

	2013 £m	2012[1] £m
Tax charge attributable to policyholders	**(247)**	(74)
Shareholder tax charge	**(1,138)**	(1)
Tax charge	**(1,385)**	(75)

[1]Restated – see note 1.

b Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to the profit before tax to the actual tax charge for the year is given below:

	2013 £m	2012[1] £m
Profit before tax	**2,994**	254
Tax charge thereon at UK corporation tax rate of 23.25 per cent (2012: 24.5 per cent)	**(696)**	(62)
Factors affecting charge:		
UK corporation tax rate change	**(408)**	(289)
Disallowed items	**(117)**	(26)
Non-taxable items	**141**	215
Overseas tax rate differences	**(11)**	72
Gains exempted or covered by capital losses	**153**	(10)
Deferred tax on losses no longer recognised following sale of Australian operations	**(348)**	–
Tax losses where no deferred tax recognised	**–**	(25)
Deferred tax on Australian tax losses not previously recognised	**60**	12
Policyholder tax	**(189)**	(56)
Adjustments in respect of previous years	**24**	81
Effect of results of joint ventures and associates	**9**	9
Other items	**(3)**	4
Tax charge on profit on ordinary activities	**(1,385)**	(75)

[1]Restated – see note 1.

15 Trading and other financial assets at fair value through profit or loss of the Group

	2013 £m	2012[1] £m
Trading assets	**37,084**	32,201
Other financial assets at fair value through profit or loss	**233**	31,470
Total	**37,317**	63,671

[1]Restated – see note 1.

These assets are comprised as follows:

	2013		2012[1]	
	Trading assets £m	**Other financial assets at fair value through profit or loss £m**	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to customers	**32,427**	**21**	28,350	22
Loans and advances to banks	**2,556**	**–**	729	–
Debt securities:				
Government securities	**115**	**–**	184	2,002
Other public sector securities	**1,458**	**–**	–	154
Bank and building society certificates of deposit	**–**	**–**	2,239	160
Asset-backed securities:				
Mortgage-backed securities	**–**	**–**	–	18
Other asset-backed securities	**4**	**–**	4	–
Corporate and other debt securities	**518**	**–**	410	4,012
	2,095	**–**	2,837	6,346
Equity shares	**–**	**212**	–	25,102
Treasury and other bills	**6**	**–**	285	–
Total	**37,084**	**233**	32,201	31,470

[1]Restated – see note 1.

At 31 December 2013 £2,624 million (2012: £39,904 million) of trading and other financial assets at fair value through profit or loss had a contractual residual maturity of greater than one year.

Other financial assets at fair value through profit or loss include the following assets designated into that category:

Other financial assets at fair value through profit or loss included financial assets backing insurance contracts and investment contracts of £29,765 million at 31 December 2012 which were so designated because the related liabilities either had cash flows that were contractually based on the performance of the assets or were contracts whose measurement took account of current market conditions and where significant measurement inconsistencies would otherwise have arisen.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £34,854 million for the Group (2012: £28,993 million). Collateral is held with a fair value of £37,746 million for the Group (2012: £33,946 million), all of which the Group is able to repledge. At 31 December 2013, £20,595 million had been repledged by the Group (2012: £30,191 million).

For amounts included above which are subject to repurchase agreements see note 51.

16 Derivative financial instruments

The Group holds derivatives as part of the following strategies:

- Customer driven, where derivatives are held as part of the provision of risk management products to Group customers;
- To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value and cash flow hedge approaches as described in note 51; and
- Derivatives held in policyholders funds as permitted by the investment strategies of those funds.

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS 39. Derivatives are held at fair value on the Group's balance sheet. A description of the methodology used to determine the fair value of derivative financial instruments and the effect of using reasonably possible alternative assumptions for those derivatives valued using unobservable inputs is set out in note 50.

The principal derivatives used by the Group are as follows:

- Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal

16 Derivative financial instruments (continued)

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.

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

	2013			2012		
Group	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**783**	**18**	**9**	543	36	44
Currency swaps	**62,061**	**654**	**778**	35,785	828	806
Options purchased	**208**	**6**	**–**	139	3	–
Options written	**246**	**–**	**6**	51	–	–
	63,298	**678**	**793**	36,518	867	850
Interest rate contracts:						
Interest rate swaps	**575,233**	**13,222**	**14,096**	454,087	23,293	24,646
Forward rate agreements	**14,456**	**7**	**1**	9,902	12	14
Options purchased	**10,955**	**516**	**–**	8,866	764	–
Options written	**12,085**	**–**	**490**	11,268	–	889
Futures	**106,035**	**–**	**6**	44,548	–	1
	718,764	**13,745**	**14,593**	528,671	24,069	25,550
Credit derivatives	**375**	**–**	**67**	435	–	57
Equity and other contracts	**7,187**	**833**	**750**	7,241	996	766
Total derivative assets/liabilities held for trading	**789,624**	**15,256**	**16,203**	572,865	25,932	27,223
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**23,876**	**3,022**	**181**	42,602	4,713	491
Cross currency swaps	**16,850**	**156**	**176**	27,299	450	219
	40,726	**3,178**	**357**	69,901	5,163	710
Derivatives designated as cash flow hedges:						
Interest rate swaps	**107,529**	**2,440**	**2,573**	111,889	4,745	3,745
Cross currency swaps	**1,135**	**12**	**4**	2,704	14	32
Options	**–**	**–**	**–**	–	–	–
Futures	**92,692**	**5**	**–**	49,527	1	–
	201,356	**2,457**	**2,577**	164,120	4,760	3,777
Derivatives designated as net investment hedges:				–		
Cross currency swaps	**–**	**–**	**–**	–	–	–
Total derivative assets/liabilities held for hedging	**242,082**	**5,635**	**2,934**	234,021	9,923	4,487
Total recognised derivative assets/liabilities	**1,031,706**	**20,891**	**19,137**	806,886	35,855	31,710

16 Derivative financial instruments (continued)

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will affect income.

2013	**0-1 years £m**	**1-2 years £m**	**2-3 years £m**	**3-4 years £m**	**4-5 years £m**	**5-10 years £m**	**10-20 years £m**	**Over 20 years £m**	**Total £m**
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**43**	**216**	**314**	**125**	**44**	**258**	**204**	**76**	**1,280**
Forecast payable cash flows	**(83)**	**(30)**	**(38)**	**(63)**	**(105)**	**(459)**	**(475)**	**(19)**	**(1,272)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**86**	**275**	**256**	**93**	**41**	**257**	**198**	**74**	**1,280**
Forecast payable cash flows	**(96)**	**(35)**	**(38)**	**(97)**	**(103)**	**(448)**	**(443)**	**(12)**	**(1,272)**

2012	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	73	123	248	206	88	243	76	119	1,176
Forecast payable cash flows	(101)	(60)	(42)	(53)	(57)	(405)	(456)	(30)	(1,204)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	114	168	233	162	73	237	70	119	1,176
Forecast payable cash flows	(123)	(54)	(47)	(55)	(63)	(408)	(433)	(21)	(1,204)

There were no transactions for which cash flow hedge accounting had to be ceased in 2013 or 2012 as a result of the highly probable cash flows no longer being expected to occur.

At 31 December 2013 £19,768 million of total recognised derivative assets of the Group and £17,630 million of total recognised derivative liabilities of the Group (2012: £31,907 million of assets and £29,447 million of liabilities) had a contractual residual maturity of greater than one year.

	2013			2012		
Company	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading						
Currency swaps	**2,927**	**405**	**–**	–	–	–
Interest rate swaps	**614**	**31**	**4**	–	–	–
Total derivative assets/liabilities held for trading	**3,541**	**436**	**4**	–	–	–
Hedging						
Derivatives designated as fair value hedges:						
Currency swaps	**1,793**	**726**	**–**	6,478	1,430	–
Interest rate swaps	**384**	**51**	**–**	597	135	10
Total recognised derivative assets/liabilities, held for hedging	**2,177**	**777**	**–**	7,075	1,565	10
Total recognised derivative asset/liabilities	**5,718**	**1,213**	**4**	7,075	1,565	10

At 31 December 2013 £1,205 million of total recognised derivative assets of the Company and £4 million of total recognised derivative liabilities of the Company (2012: £1,564 million of assets and £nil of liabilities) had a contractual residual maturity of greater than one year.

17 Loans and advances to banks

	2013 £m	2012[1] £m
Lending to banks	**839**	22
Money market placements with banks	**1,261**	4,852
Total loans and advances to banks	**2,100**	4,874

[1]Restated – see note 1.

No allowance for impaired loans was carried against these exposures at 31 December 2013 or 31 December 2012. At 31 December 2013 £447 million (2012: £926 million) of loans and advances to banks had a contractual residual maturity of greater than one year.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £nil (2012: £83 million). Collateral is held with a fair value of £nil (2012: £83 million), all of which the Group is able to repledge.

18 Loans and advances to customers

	2013 £m	2012 £m
Agriculture, forestry and fishing	**562**	501
Energy and water supply	**361**	1,200
Manufacturing	**1,177**	1,842
Construction	**2,605**	3,956
Transport, distribution and hotels	**9,649**	14,898
Postal and telecommunications	**142**	297
Property companies	**19,340**	30,163
Financial, business and other services	**10,601**	14,419
Personal:		
Mortgages	**240,996**	237,466
Other	**9,543**	13,302
Lease financing	**1,480**	2,953
Hire purchase	**56**	506
Total loans and advances to customers before allowance for impairment losses	**296,512**	321,503
Allowance for impairment losses (note 22)	**(12,874)**	(17,881)
Total loans and advances to customers	**283,638**	303,622

At 31 December 2013 £261,662 million (2012: £269,580 million) of loans and advances to customers had a contractual residual maturity of greater than one year.

Included in the amounts reported above are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £49 million (2012: £2 million).

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2013 £m	2012 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**166**	676
Later than 1 year and not later than 5 years	**599**	1,188
Later than 5 years	**1,254**	1,978
	2,019	3,842
Unearned future finance income on finance leases	**(521)**	(886)
Rentals received in advance	**(18)**	(3)
Net investment in finance leases	**1,480**	2,953

18 Loans and advances to customers (continued)

The net investment in finance leases represents amounts recoverable as follows:

	2013 £m	2012 £m
Not later than 1 year	104	553
Later than 1 year and not later than 5 years	409	871
Later than 5 years	967	1,529
Net investment in finance leases	1,480	2,953

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2013 and 2012 no contingent rentals in respect of finance leases were recognised in the income statement. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses for the Group is £6 million (2012: £30 million).

The unguaranteed residual values included in finance lease receivables were as follows:

	2013 £m	2012 £m
Not later than 1 year	–	30
Later than 1 year and not later than 5 years	–	72
Later than 5 years	–	7
Total unguaranteed residual values	–	109

19 Securitisations and covered bonds

Securitisation programmes

Loans and advances to customers and debt securities classified as loans and receivables include loans securitised under the Group's securitisation programmes, the majority of which have been sold by subsidiary companies to bankruptcy remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by the subsidiary, the structured entities are consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue. In addition to the structured entities described below, the Group sponsors a conduit programme, Grampian (note 20).

Covered bond programmes

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of covered bonds by the Group. The Group retains all of the risks and rewards associated with these loans and the partnerships are consolidated fully with the loans retained on the Group's balance sheet and the related covered bonds in issue included within debt securities in issue.

The Group's principal securitisation and covered bond programmes, together with the balances of the advances subject to these arrangements and the carrying value on the notes in issue at 31 December, are listed below. The notes in issue are reported in note 34.

	2013		2012	
	Loans and advances securitised £m	**Notes in issue £m**	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes				
UK residential mortgages	**38,096**	**28,536**	44,647	32,201
US residential mortgage-backed securities	**–**	**–**	3,909	5,237
Irish residential mortgages	**–**	**–**	5,194	3,509
Credit card receivables	**6,332**	**3,992**	7,001	3,794
Dutch residential mortgages	**4,385**	**4,516**	4,551	4,692
Commercial loans	**524**	**524**	675	675
Motor vehicle loans	**–**	**–**	1,039	1,086
	49,337	**37,568**	67,016	51,194
Less held by the Group		**(24,975)**		(33,570)
Total securitisation programmes (note 34)		**12,593**		17,624
Covered bond programmes				
Residential mortgage-backed	**30,467**	**19,622**	46,311	33,414
Social housing loan-backed	**2,536**	**1,800**	2,934	2,400
	33,003	**21,422**	49,245	35,814
Less held by the Group		**(7,606)**		(10,226)
Total covered bond programmes (note 34)		**13,816**		25,588
Total securitisation and covered bond programmes		**26,409**		43,212

Cash deposits of £9,881 million (2012: £12,710 million) held by the Group are restricted in use to repayment of the debt securities issued by the structured entities, the term advances relating to covered bonds and other legal obligations. Additionally, the Group had certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2013 these obligations had not been triggered and the maximum exposure under these facilities was £221 million (2012: £221 million).

The Group has a number of covered bond programmes, for which Limited Liability Partnerships have been established to ring-fence asset pools and guarantee the covered bonds issued by the Group. At the reporting date the Group had over-collateralised these programmes as set out in the table above to meet the terms of the programmes, to secure the rating of the covered bonds and to provide operational flexibility. From time-to-time, the obligations of the Group to provide collateral may increase due to the formal requirements of the programmes. The Group may also voluntarily contribute collateral to support the ratings of the covered bonds.

The Group recognises the full liabilities associated with its securitisation and covered bond programmes within debt securities in issue, although the obligations of the Group are limited to the cashflows generated from the underlying assets. The Group could be required to provide additional support to a number of the securitisation programmes to support the credit ratings of the debt securities issued, in the form of increased cash reserves and the holding of subordinated notes. Further, certain programmes contain contractual obligations that require the Group to repurchase assets should they become credit impaired.

The Group has not voluntarily offered to repurchase assets from any of its public securitisation programmes during 2013 (2012: £471 million was voluntarily repurchased). Such repurchases are made in order to ensure that the expected maturity dates of the notes issued from these programmes are met.

20 Structured entities

The Group's interests in structured entities are consolidated. Detail of the Group's interests in consolidated structured entities are set out in: note 19 for securitisations and covered bonds and below.

During the year the Group held interests in consolidated and unconsolidated structured entities through its investment in St James's Place plc which held interests in collective investment vehicles, such as unit trusts. During 2013 the Group completed the sale of all of its holding in St James's Place plc as set out in note 9. Therefore at 31 December 2013 the Group's total carrying value of consolidated collective investment vehicle assets and liabilities was £nil (2012: £20,584 million).

Asset-backed conduits
In addition to the structured entities discussed in note 19, which are used for securitisation and covered bond programmes, the Group sponsors an asset-backed conduit, Grampian, which invests in debt securities. All the external assets in the conduit are consolidated in the Group's financial statements. The total consolidated exposures in the conduit are set out in the table below:

	2013 £m	2012 £m
Loans and advances	**9**	59
Debt securities classified as loans and receivables:		
Asset-backed securities	**–**	358
Debt securities classified as available-for-sale financial assets:		
Asset-backed securities	**–**	143
Total assets	**9**	560

Grampian has no Commercial Paper in issue and no external liquidity providers. Any restriction on the use of the assets included in the table above by the Group is due to their use in repurchase transactions see note 18 and note 50.

21 Debt securities classified as loans and receivables

Debt securities accounted for as loans and receivables comprise:

	2013 £m	2012 £m
Asset-backed securities:		
Mortgage-backed securities	**158**	4,114
Other asset-backed securities	**228**	416
Corporate and other debt securities	**274**	271
Total debt securities classified as loans and receivables before allowance for impairment losses	**660**	4,801
Allowance for impairment losses (note 22)	**(131)**	(988)
Total debt securities classified as loans and receivables	**529**	3,813

At 31 December 2013, £519 million (2012: £3,872 million) of debt securities classified as loans and receivables of the Group had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase agreements see note 51.

22 Allowances for impairment losses on loans and receivables

	Loans and advances to customers £m	Debt securities £m	Total £m
Balance at 1 January 2012	23,351	1,148	24,499
Exchange and other adjustments	(305)	(41)	(346)
Advances written off	(9,572)	(151)	(9,723)
Recoveries of advances written off in previous years	484	15	499
Unwinding of discount	(329)	–	(329)
Charge to the income statement (note 12)	4,252	17	4,269
At 31 December 2012	17,881	988	18,869
Exchange and other adjustments	**271**	**52**	**323**
Disposal of business	**(61)**	**–**	**(61)**
Advances written off	**(7,519)**	**(885)**	**(8,404)**
Recoveries of advances written off in previous years	**106**	**–**	**106**
Unwinding of discount	**(228)**	**–**	**(228)**
Charge to the income statement (note 12)	**2,424**	**(24)**	**2,400**
At 31 December 2013	**12,874**	**131**	**13,005**

Of the Group's total allowance in respect of loans and advances to customers, £11,932 million (2012: £16,726 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date. Of the total allowance in respect of loans and advances to customers, £2,583 million (2012: £3,724 million) was assessed on a collective basis.

23 Available-for-sale financial assets

	2013 £m	2012 £m
Debt securities:		
Government securities	**113**	113
Bank and building society certificates of deposit	**15**	25
Asset-backed securities:		
Mortgage-backed securities	**749**	882
Other asset-backed securities	**518**	306
Corporate and other debt securities	**1,525**	4,256
	2,920	5,582
Equity shares	**413**	470
Total available-for-sale financial assets	**3,333**	6,052

At 31 December 2013 £3,117 million (2012: £4,997 million) of available-for-sale financial assets had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase agreements see note 51.

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 2h(2).

24 Investment properties

	2013 £m	2012 £m
At 1 January	**1,279**	1,686
Exchange and other adjustments	**3**	25
Additions:		
Acquisitions of new properties	**–**	162
Consolidation of new subsidiary undertakings	**805**	411
Additional expenditure on existing properties	**48**	27
Total additions	**853**	600
Disposals	**(832)**	(916)
Changes in fair value (note 7)	**(95)**	(116)
Disposal of businesses (note 53e)	**(582)**	–
At 31 December	**626**	1,279

In addition, the following amounts have been recognised in the income statement:

	2013 £m	2012 £m
Rental income (note 9)	**46**	85
Direct operating expenses arising from investment properties that generate rental income	**1**	5

The investment properties are valued at least annually at open-market value, by independent professionally qualified valuers, who have recent experience in the location and categories of the investment properties being valued.

The fair value of investment properties is measured using the market approach and incorporates the income approach where appropriate. The fair value of investment property is generally measured using observable inputs. Whether investment properties are categorised as level 2 or 3 (see note 50 (4) for details of levels in the fair value hierarchy) depends on the extent of the adjustments made to observable inputs and this depends on the investment property concerned. Investment property is compared to property for which there is observable market data about its realisable value on disposal. Adjustments to this observable data are applied, if necessary, for specific characteristics of the property, such as the nature, location or condition of the specific asset. If such information is not available, alternative valuation methods using unobservable inputs, such as discounted cash flow analysis or recent prices in less active markets are used. For investment property under construction, the value on disposal is considered to be at the point at which the property is fully constructed. Adjustments are made for the costs and risks associated with construction. Investment property under construction for which fair value is not yet reliably measurable is valued at cost, until the fair value can be reliably measured.

The table above analyses movements in investment properties, all of which are categorised as level 3.

25 Investment in subsidiary undertakings

	2013 £m	2012 £m
At 1 January	**23,000**	23,000
Disposals (note 53(e))	**(914)**	–
At 31 December	**22,086**	23,000

The principal group undertaking, which has prepared accounts to 31 December and whose results are included in the consolidated accounts of HBOS plc, is:

	Share class	Company's interest in ordinary share capital and voting rights	Country of incorporation	Principal business
Bank of Scotland plc	Ordinary	100%	UK	Banking, financial and related services

The principal area of operation of the above group undertaking is the United Kingdom.

25 Investment in subsidiary understakings (continued)

In November 2009, as part of the restructuring plan that was a requirement for European Commission approval of state aid received, Lloyds Banking Group plc agreed to suspend the payment of coupons and dividends on certain Group preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. Lloyds Banking Group plc also agreed to temporarily suspend and/or waive dividend payments on certain preference shares which have been issued intra-group. Consequently, in accordance with the terms of some of these instruments, subsidiaries could have been prevented from making dividend payments on ordinary shares during this period. In addition, certain subsidiary companies currently have insufficient distributable reserves to make dividend distributions.

Subject to the foregoing, there were no further significant restrictions on any of the Company's subsidiaries in paying dividends or repaying loans and advances. All regulated banking and insurance subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make payments.

26 Goodwill

	2013 £m	2012 £m
At 1 January	859	859
Disposal of businesses (note 56(e))	(474)	–
Impairment charged to the income statement	(51)	–
At 31 December	**334**	859
Cost[1]	1,847	1,847
Accumulated impairment losses	(1,513)	(988)
At 31 December	**334**	859

[1]For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is included net of amounts amortised up to 31 December 2003.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. This compares the 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; of the total balance of £334 million (2012: £859 million), £325 million (or 97 per cent of the total) has been allocated to retail banking activities.

The recoverable amount of goodwill carried at 31 December 2013 has been based upon value in use. This calculation uses cash flow projections based upon the five year business plan where 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. Cash flows for the period subsequent to the term of the business plan are not considered for the purposes of impairment testing. The discount rate used in discounting the projected cash flows is 12.0 per cent (pre-tax) reflecting, inter alia, 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.

The Group incurred a £51 million write-off of goodwill during 2013 following the impairment review of goodwill relating to an acquisition made in previous years.

27 Value of in-force business

The gross value of in-force business asset in the consolidated balance sheet is as follows:

	2013 £m	2012 £m
Acquired value of in-force non-participating investment contracts	–	98
Value of in-force insurance and participating investment contracts	–	37
Total value of in-force business	**–**	135

The movement in the acquired value of in-force non-participating investment contracts over the year is as follows:

	2013 £m	2012 £m
At 1 January	98	105
Amortisation taken to income statement (note 11)	(2)	(7)
Disposal of businesses (note 53(e))	(96)	–
At 31 December	**–**	98

27 Value of in force business (continued)

The movement in the value of in-force insurance and participating investment contracts over the year is as follows:

	2013 £m	2012 £m
At 1 January	**37**	42
Exchange and other adjustments		–
New business	**–**	–
Existing business:		
Expected return	**(9)**	(5)
Experience variances	**–**	–
Non-economic assumption changes	**–**	–
Economic variance	**–**	–
Movement in the value of in-force business taken to income statement (note 9)	**(9)**	(5)
Disposal of businesses (note 53(e))	**(28)**	–
At 31 December	**–**	37

This breakdown shows the movement in the value of in-force business only, and does not represent the full contribution that each item in the breakdown contributes to profit before tax. This will also contain changes in the other assets and liabilities, including the effects of changes in assumptions used to value liabilities, of the relevant businesses. Economic variance is the element of earnings which is generated from changes to economic experience in the period and to economic assumptions over time. The presentation of economic variance includes the impact of financial market conditions being different at the end of the reporting period from those included in assumptions used to calculate new and existing business returns.

The principal features of the methodology and process used for determining key assumptions used in the calculation of the value of in-force business are set out below:

Economic assumptions
Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn a risk-free rate and all cash flows are discounted at a risk-free rate.

A market-consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date. The risk-free rate used for the value of financial options and guarantees is defined as the spot yield derived from the relevant government bond yield curve in line with FSA realistic balance sheet assumptions.

The risk-free rate assumed in valuing the non-annuity in-force business is the 15 year government bond yield for the appropriate territory.

The table below shows the risk-free rate and other key assumptions at 31 December for UK business:

	2013 %	2012 %
Risk-free rate (value of in-force non-annuity business)	**–**	1.80
Retail price inflation	**–**	2.50
Expense inflation	**–**	3.40

Non-market risk
An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk, reinsurer default and the with-profit funds there are asymmetries in the range of potential outcomes for which an explicit allowance is made.

Non-economic assumptions
Future mortality, morbidity, expenses, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of likely future experience.

Mortality and morbidity
The mortality and morbidity assumptions, including allowances for improvements in longevity, are set with regard to the Group's actual experience where this provides a reliable basis and relevant industry data otherwise.

Lapse (persistency) and paid-up rates
Lapse and paid up rates assumptions are reviewed each year. The most recent experience is considered along with the results of previous analyses and management's views on future experience. In determining this best estimate view, a number of factors are considered, including the credibility of the results (which will be affected by the volume of data available), any exceptional events that have occurred during the period under consideration and any known or expected trends in underlying data.

Maintenance expenses
Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs. Explicit allowance is made for future expense inflation.

28 Other intangible assets

Group	The Group: Purchased credit card receivables £m	The Group: Brands £m	The Group: Capitalised software enhancements £m	The Group: Total £m	Company: Brands £m
Cost:					
At 1 January 2012	–	24	302	326	10
Additions	–	–	45	45	–
Disposals	–	–	(76)	(76)	–
At 31 December 2012	–	24	271	295	10
Additions	**15**	**–**	**25**	**40**	**–**
Disposals	**–**	**–**	**(179)**	**(179)**	**–**
At 31 December 2013	**15**	**24**	**117**	**156**	**10**
Accumulated amortisation:					
At 1 January 2012	–	24	226	250	10
Exchange and other adjustments	–	–	4	4	–
Charge for the year (note 11)	–	–	14	14	–
Disposals	–	–	(76)	(76)	–
At 31 December 2012	–	24	168	192	10
Charge for the year (note 11)	**2**	**–**	**13**	**15**	**–**
Disposals	**–**	**–**	**(146)**	**(146)**	**–**
At 31 December 2013	**2**	**24**	**35**	**61**	**10**
Balance sheet amount at 31 December 2013	**13**	**–**	**82**	**95**	**–**
Balance sheet amount at 31 December 2012	–	–	103	103	–

Capitalised software enhancements principally comprise identifiable and directly associated internal staff and other costs.

29 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2012	1,400	2,506	1,833	5,739
Exchange and other adjustments	1	(4)	(320)	(323)
Additions	49	156	41	246
Disposals	(20)	(204)	(544)	(768)
Disposal of businesses (note 53(e))	–	(608)	–	(608)
At 31 December 2012	1,430	1,846	1,010	4,286
Exchange and other adjustments	**6**	**3**	**(12)**	**(3)**
Additions	**33**	**93**	**26**	**152**
Disposals	**(45)**	**(67)**	**(283)**	**(395)**
Disposal of businesses	**(2)**	**(72)**	**(80)**	**(154)**
At 31 December 2013	**1,422**	**1,803**	**661**	**3,886**
Accumulated depreciation and impairment:				
At 1 January 2012	781	2,027	559	3,367
Exchange and other adjustments	(1)	(4)	(98)	(103)
Depreciation charge for the year (note 11)	49	101	86	236
Disposals	(11)	(152)	(148)	(311)
Disposal of businesses (note 53(e))	–	(608)	–	(608)
At 31 December 2012	818	1,364	399	2,581
Exchange and other adjustments	**2**	**(9)**	**(8)**	**(15)**
Depreciation charge for the year (note 11)	**57**	**102**	**52**	**211**
Disposals	**(33)**	**(50)**	**(134)**	**(217)**
Disposal of businesses	**–**	**(57)**	**(32)**	**(89)**
At 31 December 2013	**844**	**1,350**	**277**	**2,471**
Balance sheet amount at 31 December 2013	**578**	**453**	**384**	**1,415**
Balance sheet amount at 31 December 2012	612	482	611	1,705

At 31 December the future minimum rentals receivable by the Group under non-cancellable operating leases were as follows:

	2013 £m	2012 £m
Receivable within 1 year	**49**	128
1 to 5 years	**104**	200
Over 5 years	**177**	216
Total future minimum rentals receivable	**330**	544

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2013 and 2012 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £1 million at 31 December 2013 (2012: £nil) is expected to be received under non-cancellable sub-leases of the Group's premises.

30 Other assets

	Group 2013 £m	Group 2012[1] £m	Company 2013 £m	Company 2012 £m
Assets arising from reinsurance contracts held (notes 35 and 36)	**–**	42	**–**	–
Deferred acquisition costs (see below)	**–**	938	**–**	–
Settlement balances	**1,935**	537	**–**	–
Investments in joint ventures and associates (note 13)	**76**	306	**–**	–
Assets of disposal group[2]	**169**	–	**–**	–
Other assets and prepayments	**988**	3,109	**14**	17
Total other assets	**3,168**	4,932	**14**	17

[1]Restated – see note 1.

[2]Assets of disposal group at 31 December 2013 comprised the Group's investment in Sainsbury's Bank plc.

Deferred acquisition costs of the Group:	2013 £m	2012 £m
At 1 January	**938**	772
Acquisition costs deferred, net of amounts amortised to the income statement	**–**	166
Disposal of business	**(938)**	–
At 31 December	**–**	938

31 Deposits from banks

	2013 £m	2012 £m
Liabilities in respect of securities sold under repurchase agreements	**623**	2,612
Other deposits from banks	**2,552**	4,502
Total deposits from banks	**3,175**	7,114

At 31 December 2013 £855 million (2012: £1,229 million) of deposits from banks had a contractual residual maturity of greater than one year.

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £623 million (2012: £2,612 million) and a fair value of £720 million (2012: £4,539 million).

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £nil (2012: £4 million).

32 Customer deposits of the Group

	2013 £m	2012 £m
Non-interest bearing current accounts	**13,764**	11,955
Interest bearing current accounts	**22,481**	19,788
Savings and investment accounts	**163,077**	161,059
Other customer deposits	**7,246**	12,467
Total customer deposits	**206,568**	205,269

At 31 December 2013 £33,807 million (2012: £42,320 million) of customer deposits had a contractual residual maturity of greater than one year.

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £416 million (2012: £192 million).

33 Trading and other financial liabilities at fair value through profit or loss

	2013 £m	2012 £m
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	**31,562**	32,449
Short positions in securities	**5,023**	1,146
Other financial liabilities at fair value through profit or loss:		
Other	**39**	15
Trading liabilities	**36,624**	33,610

At 31 December 2013 £935 million (2012: £7,848 million) of trading liabilities had a contractual residual maturity of greater than one year.

34 Debt securities in issue

	2013 £m	2012 £m
Medium-term notes issued	**2,810**	5,615
Covered bonds (note 19)	**13,816**	25,588
Certificates of deposit	**–**	29
Securitisation notes (note 19)	**12,593**	17,624
Commercial paper	**–**	130
	29,219	48,986
Amounts due to fellow Group undertakings	**243**	535
Total debt securities in issue	**29,462**	49,521

At 31 December 2013 £25,169 million (2012: £39,895 million) of debt securities in issue had a contractual residual maturity of greater than one year.

35 Liabilities arising from insurance contracts and participating investment contracts

Life insurance

Insurance contract and participating investment contract liabilities at 31 December 2012 related to life insurance business.

The movement in these life insurance contract and participating investment contract liabilities over the year can be analysed as follows:

	Gross insurance contracts £m	Reinsurance £m	Net £m
At 1 January 2012	385	(38)	347
Exchange and other adjustments			
New business	–	–	–
Changes in existing business	38	(4)	34
Change in liabilities charged to the income statement (note 10)	38	(4)	34
At 31 December 2012	423	(42)	381
Exchange and other adjustments			
New business	**–**	**–**	**–**
Changes in existing business	**42**	**5**	**47**
Change in liabilities charged to the income statement (note 10)	**42**	**5**	**47**
Disposal of businesses (note 53(e))	**(465)**	**37**	**(428)**
At 31 December 2013	**–**	**–**	**–**

Liabilities for life insurance contracts and participating investment contracts at 31 December 2012 related to non-profit fund liabilities, accounted for using a prospective actuarial discounted cash flow methodology, as follows:

Non-profit fund liabilities

(i) Business description

The Group principally writes the following types of life insurance contracts within its non-profit funds. Shareholder profits on these types of business arise from management fees and other policy charges.

Unit-linked business – This includes unit-linked pensions and unit-linked bonds, the primary purpose of which is to provide an investment vehicle where the policyholder is also insured against death.

35 Liabilities arising from insurance contracts and participating investment contracts (continued)

Life insurance – The policyholder is insured against death or permanent disability, usually for predetermined amounts. Such business includes whole of life and term assurance and long-term creditor policies.

(ii) Method of calculation of liabilities
The non-profit fund liabilities are determined on the basis of recognised actuarial methods and consistent with the approach required by regulatory rules. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting the cash flows back to the valuation date allowing for probabilities of occurrence.

(iii) Assumptions
Generally, assumptions used to value non-profit fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of non-profit fund liabilities are:

Interest rates
The rates used are derived in accordance with the guidelines set by local regulatory bodies. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the guidelines set by local regulatory bodies, including reductions made to the available yields to allow for default risk based upon the credit rating of the securities allocated to the insurance liability.

Mortality and morbidity
The mortality and morbidity assumptions, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and include a margin for adverse deviation.

Lapse rates (persistency)
Lapse rates are allowed for on some non-profit fund contracts. Lapse rates refer to the rate of policy termination or the rate at which policyholders stop paying regular premiums due under the contract.

Historical persistency experience is analysed using statistical techniques. As experience can vary considerably between different product types and for contracts that have been in force for different periods, the data is broken down into broadly homogenous groups for the purpose of this analysis.

The most recent experience is considered along with the results of previous analyses and management's views on future experience, taking into consideration potential changes in future experience that may result from guarantees and options becoming more valuable under adverse market conditions, in order to determine a 'best estimate' view of what persistency will be. In determining this best estimate view a number of factors are considered, including the credibility of the results (which will be affected by the volume of data available), any exceptional events that have occurred during the period under consideration, any known or expected trends in underlying data and relevant published market data. Prudent scenario is assumed by the inclusion of a margin for adverse deviation within the non-profit fund liabilities.

Maintenance expenses
Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation. Explicit allowance is made for future expense inflation.

36 Liabilities arising from non-participating investment contracts

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

	Gross £m	Reinsurance £m	Net £m
At 1 January 2012	22,207	–	22,207
New business	4,088	–	4,088
Changes in existing business	871	–	871
At 31 December 2012	27,166	–	27,166
New business	**1,142**	**–**	**1,142**
Changes in existing business	**1,645**	**–**	**1,645**
Disposal of businesses (note 53(e))	**(29,953)**	**–**	**(29,953)**
At 31 December 2013	**–**	**–**	**–**

37 Other liabilities

	Group		Company	
	2013 £m	2012[1] £m	**2013 £m**	2012 £m
Settlement balances	**2,348**	1,278	**–**	–
Unitholders' interest in Open Ended Investment Companies	**–**	5,368	**–**	–
Other creditors and accruals	**2,893**	4,534	**503**	469
	5,241	11,180	**503**	469

[1]Restated – see note 1.

38 Retirement benefit obligations

	The Group	
	2013 £m	2012[1] £m
Charge to the Group income statement		
Past service charges (credits)[2]	**–**	(258)
Other	**135**	117
Defined benefit pension schemes	**135**	(141)
Other post-retirement benefit schemes	**4**	5
Total defined benefit schemes	**139**	(136)
Defined contribution pension schemes	**79**	63
Total charge to the income statement	**218**	(73)

[1]Restated – see note 1.

[2]In 2012, there was a net credit of £258 million following a decision to link discretionary pension increases in certain schemes to the Consumer Price Index (note 11).

	The Group		Company	
	2013 £m	2012[1] £m	**2013 £m**	2012[1] £m
Amounts recognised in the balance sheet				
Retirement benefit assets	**39**	733	**39**	733
Retirement benefit obligations	**(280)**	(195)	**(235)**	(141)
Total amounts recognised in the balance sheet	**(241)**	538	**(196)**	592

The total amount recognised in the balance sheet relates to:

	The Group		Company	
	2013 £m	2012[1] £m	**2013 £m**	2012[1] £m
Defined benefit pension schemes	**(162)**	617	**(117)**	671
Other post-retirement benefit schemes	**(79)**	(79)	**(79)**	(79)
Total amounts recognised in the balance sheet	**(241)**	538	**(196)**	592

[1]Restated – see note 1.

Pension schemes
Defined benefit schemes
(I) CHARACTERISTICS OF AND RISKS ASSOCIATED WITH THE GROUP'S SCHEMES
The Group has established a number of defined benefit pension schemes in the UK and overseas. All significant schemes are based in the UK, with the most significant being the defined benefit section of the HBOS Final Salary Pension Scheme. These schemes provide retirement benefits calculated as a percentage of final pensionable salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2013 was generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The Group operates a number of funded and unfunded pension arrangements, the majority, including the three most significant schemes, are funded schemes in the UK. All schemes are operated as separate legal entities under trust law by the trustees. All UK schemes are funded in compliance with the Pensions Act 2004. A valuation exercise is carried out for each scheme at least every three years, whereby scheme assets are measured at market value and liabilities ('Technical Provisions') are measured using prudent assumptions, if a deficit is identified a recovery plan is agreed and sent to the Pensions Regulator for review. The outcome of this valuation process, including agreement of any recovery plans, is agreed between the Group and the scheme Trustee. The Group's overseas defined benefit pension schemes are subject to local regulatory arrangements.

The latest full valuations of the main scheme was carried out as at 30 June 2011; the results have been updated to 31 December 2013 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2013 by qualified independent actuaries.

During 2013 the Group 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 2013 this company held assets of approximately £1.8 billion; the company does not make any distributions to the pension scheme. The private limited company is consolidated in the Group's balance sheet. The terms of this arrangement require the Group to maintain assets in this vehicle to agreed minimum values in order to secure obligations owed to the Group pension schemes. The Group has satisfied this requirement during 2013.

The Group currently expects to pay contributions of approximately £195 million to its defined benefit schemes in 2014.

The responsibility for the governance of the Group's funded defined benefit pension schemes lies with the Pension Trustees. Each of the Group's funded UK defined benefit pension schemes are managed by a Trustee Board (the Trustee) whose role is to ensure that their Scheme is administered in accordance with the Scheme rules and relevant legislation, and to safeguard the assets in the best interests of all members and beneficiaries. The Trustee is solely responsible for setting investment policy and for agreeing funding requirements with the employer through the triennial valuation process. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

38 Retirement benefit obligations (continued)

(II) AMOUNTS IN THE FINANCIAL STATEMENTS

	The Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Amount included in the balance sheet				
Present value of funded obligations	**(10,939)**	(9,881)	**(10,737)**	(9,682)
Fair value of scheme assets	**10,777**	10,498	**10,620**	10,353
Net amount recognised in the balance sheet	**(162)**	617	**(117)**	671

	The Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Net amount recognised in the balance sheet				
At 1 January	**617**	882	**671**	916
Net defined benefit pension expense	**(135)**	141	**(130)**	147
Actuarial losses on defined benefit obligation	**(758)**	(835)	**(760)**	(803)
Return on plan assets	**(73)**	98	**(72)**	93
Employer contributions	**185**	330	**172**	322
Benefits paid	**2**	–	**2**	–
Exchange and other adjustments	**–**	1	**–**	(4)
At 31 December	**(162)**	**617**	**(117)**	671

	The Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Movements in the defined benefit obligation				
At 1 January	**(9,881)**	(8,999)	**(9,682)**	(8,832)
Current service cost	**(147)**	(152)	**(146)**	(151)
Interest expense	**(447)**	(433)	**(439)**	(426)
Remeasurements:				
Actuarial (losses) gains – experience	**(9)**	(117)	**(8)**	(117)
Actuarial (losses) gains – demographic assumptions	**11**	(47)	**12**	(47)
Actuarial (losses) gains – financial assumptions	**(760)**	(671)	**(763)**	(639)
Benefits paid	**300**	284	**289**	281
Past service cost	**(7)**	(19)	**(7)**	(15)
Employee contributions	**(1)**	(1)	**(1)**	(1)
Curtailments	**–**	258	**–**	258
Settlements	**6**	–	**8**	–
Exchange and other adjustments	**(4)**	16	**–**	7
At 31 December	**(10,939)**	(9,881)	**(10,737)**	(9,682)
The total defined benefit obligation comprises:				
Amounts owing to active members	**(3,276)**	(2,939)	**(3,268)**	(2,930)
Amounts owing to deferred members	**(3,150)**	(2,820)	**(3,020)**	(2,681)
Amounts owing to pensioners	**(4,227)**	(3,861)	**(4,163)**	(3,810)
Amounts owing to dependents	**(286)**	(261)	**(286)**	(261)
Total defined benefit obligation at 31 December	**(10,939)**	(9,881)	**(10,737)**	(9,682)

38 Retirement benefit obligations (continued)

	The Group 2013 £m	The Group 2012 £m	Company 2013 £m	Company 2012 £m
Changes in the fair value of scheme assets				
At 1 January	**10,498**	9,881	**10,353**	9,748
Return on plan assets excluding amounts included in interest income	**(73)**	98	**(72)**	93
Interest income	**482**	497	**476**	491
Employer contributions	**185**	330	**172**	322
Employee contributions	**1**	1	**1**	1
Benefits paid	**(298)**	(284)	**(288)**	(281)
Settlements	**(13)**	–	**(13)**	–
Administrative costs paid	**(9)**	(10)	**(9)**	(10)
Exchange and other adjustments	**4**	(15)	**–**	(11)
At 31 December	**10,777**	10,498	**10,620**	10,353

Composition of scheme assets:

The Group	**2013 Quoted £m**	**2013 Unquoted £m**	**2013 Total £m**	2012 Quoted £m	2012 Unquoted £m	2012 Total £m
Equity instruments	**618**	**–**	**618**	709	–	709
Debt instruments	**5,406**	**–**	**5,406**	2,827	–	2,827
Property	**–**	**296**	**296**	–	293	293
Pooled investment vehicles	**2,434**	**1,920**	**4,354**	2,513	3,744	6,257
Money market instruments, derivatives, cash and other assets and liabilities	**(27)**	**130**	**103**	150	262	412
At 31 December	**8,431**	**2,346**	**10,777**	6,199	4,299	10,498

Company	**2013 Quoted £m**	**2013 Unquoted £m**	**2013 Total £m**	2012 Quoted £m	2012 Unquoted £m	2012 Total £m
Equity instruments	**568**	**–**	**568**	671	–	671
Debt instruments	**5,351**	**–**	**5,351**	2,780	–	2,780
Property	**–**	**292**	**292**	–	289	289
Pooled investment vehicles	**2,386**	**1,920**	**4,306**	2,468	3,744	6,212
Money market instruments, derivatives, cash and other assets and liabilities	**(27)**	**130**	**103**	151	250	401
At 31 December	**8,278**	**2,342**	**10,620**	6,070	4,283	10,353

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

38 Retirement benefit obligations (continued)

An analysis by credit rating of the pension schemes' debt securities is provided below:

The Group	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m £m	Not rated £m	Total £m
At 31 December 2013							
Fixed interest government bonds	**634**	**699**	**96**	**204**	**78**	**–**	**1,711**
Index linked government bonds	**1,516**	**–**	**–**	**–**	**–**	**–**	**1,516**
Corporate and other debt securities	**86**	**271**	**684**	**746**	**296**	**45**	**2,128**
Asset-backed securities	**–**	**–**	**–**	**–**	**–**	**51**	**51**
Total debt securities	**2,236**	**970**	**780**	**950**	**374**	**96**	**5,406**
At 31 December 2012							
Fixed interest government bonds	388	22	–	32	–	–	442
Index linked government bonds	938	–	–	–	–	–	938
Corporate and other debt securities	117	231	539	388	70	55	1,400
Asset-backed securities	–	–	–	–	–	47	47
Total debt securities	1,443	253	539	420	70	102	2,827

Company	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m £m	Not rated £m	Total £m
At 31 December 2013							
Fixed interest government bonds	**634**	**699**	**96**	**204**	**78**	**–**	**1,711**
Index linked government bonds	**1,516**	**–**	**–**	**–**	**–**	**–**	**1,516**
Corporate and other debt securities	**86**	**271**	**684**	**745**	**296**	**42**	**2,124**
Total debt securities	**2,236**	**970**	**780**	**949**	**374**	**42**	**5,351**
At 31 December 2012							
Fixed interest government bonds	388	22	–	32	–	–	442
Index linked government bonds	938	–	–	–	–	–	938
Corporate and other debt securities	117	231	539	388	70	55	1,400
Total debt securities	1,443	253	539	420	70	55	2,780

38 Retirement benefit obligations (continued)

The pension schemes' pooled investment vehicles comprise:

	The Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
UK equity investment funds	**28**	1,382	**28**	1,382
Non-UK equity investment funds	**26**	137	**26**	137
Fixed interest and index linked government bond funds	**47**	117	**47**	117
Private equity	**66**	51	**66**	51
Infrastructure funds	**102**	80	**102**	80
Property partnerships and unit trusts	**31**	32	**31**	32
Hedge and mutual funds	**1,384**	1,284	**1,336**	1,239
Reinsurance (OEICs) vehicles	**327**	315	**327**	315
Emerging market equity funds	**161**	163	**161**	163
Emerging market debt funds	**334**	342	**334**	342
Liquidity funds	**1,848**	2,354	**1,848**	2,354
At 31 December	**4,354**	6,257	**4,306**	6,212

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

	The Group	
	2013 £m	2012 £m
Current service cost	**147**	152
Net interest amount	**(35)**	(64)
Past service credits and curtailments (see below)	**–**	(258)
Settlements	**7**	–
Past service cost – plan amendments	**7**	19
Plan administration costs incurred during the year	**9**	10
Total defined benefit pension expense	**135**	(141)

Following a review of policy in respect of discretionary pension increases in relation to the Group's defined benefit pension schemes, increases in certain schemes are now linked to the Consumer Price Index rather than the Retail Price Index. The impact of this change was a reduction in the Group's defined benefit obligation of £258 million, recognised in the Group's income statement in 2012.

38 Retirement benefit obligations (continued)

Assumptions

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

	2013 %	2012 %
Discount rate	**4.60**	4.60
Rate of inflation:		
Retail Prices Index	**3.30**	2.90
Consumer Price Index	**2.30**	2.00
Rate of salary increases	**2.00**	2.00
Rate of increase for pensions in payment	**2.80**	2.70
	2013 Years	2012 Years
Life expectancy for member aged 60, on the valuation date:		
Men	**26.9**	26.9
Women	**29.4**	29.4
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.1**	28.0
Women	**30.7**	30.6

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 at 31 December 2013 is assumed to live for, on average, 26.9 years for a male and 29.4 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

(III) AMOUNT TIMING AND UNCERTAINTY OF FUTURE CASH FLOWS

Risk exposure of the defined benefit schemes

Whilst the Group is not exposed to any unusual, entity specific or scheme specific risks in its defined benefit pension schemes, it is exposed to a number of significant risks, detailed below:

Inflation rate risk: the majority of the plans' benefit obligations are linked to inflation both in deferment and once in payment. Higher inflation will lead to higher liabilities although this will be partially offset by holdings of inflation-linked gilts and, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation.

Interest rate risk: The defined benefit obligation is determined using a discount rate derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities although this will be partially offset by an increase in the value of bond holdings.

Longevity risk: The majority of the schemes obligations are to provide benefits for the life of the members so increases in life expectancy will result in an increase in the plans' liabilities.

Investment risk: Scheme assets are invested in a diversified portfolio of debt securities, equities and other return-seeking assets. If the assets underperform the discount rate used to calculate the defined benefit obligation, it will reduce the surplus or increase the deficit. Volatility in asset values and the discount rate will lead to volatility in the net pension liability on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the IAS 19 pension expense in the Group's income statement.

The ultimate cost of the defined benefit obligations to the Group will depend upon actual future events rather than the assumptions made. The assumptions made are unlikely to be borne out in practice and as such the cost may be higher or lower than expected.

38 Retirement benefit obligations (continued)

Sensitivity analysis

The effect of reasonably possible changes in key assumptions on the value of scheme liabilities and the resulting pension charge in the Group's income statement and on the net defined benefit pension scheme liability, for the Group's most significant scheme, is set out below. The sensitivities provided assume that all other assumptions and the value of the schemes' assets remain unchanged, and are not intended to represent changes that are at the extremes of possibility. The calculations are approximate in nature and full detailed calculations could lead to a different result. It is unlikely that isolated changes to individual assumptions will be experienced in practice. Due to the correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of simultaneous changes in multiple assumptions.

	Effect of reasonably possible alternative assumptions			
	Increase (decrease) in the income statement charge		Increase (decrease) in the net defined benefit pension scheme liability	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Inflation (including pension increases):[1]				
Increase of 0.5 per cent	**38**	53	**580**	859
Decrease of 0.5 per cent	**(34)**	(36)	**(559)**	(533)
Discount rate:[2]				
Increase of 0.5 per cent	**(67)**	(62)	**(964)**	(837)
Decrease of 0.5 per cent	**62**	63	**1,069**	965
Expected life expectancy of members:				
Increase of one year	**13**	15	**224**	211
Decrease of one year	**(14)**	(15)	**(224)**	(211)

[1]At 31 December 2013, the assumed rate of RPI inflation is 3.3 per cent and CPI inflation 2.3 per cent (2012: RPI 2.90 per cent and CPI 2.00 per cent).

[2]At 31 December 2013, the assumed discount rate is 4.6 per cent (2012: 4.60 per cent).

Sensitivity analysis method and assumptions

The sensitivity analysis above reflects the impact on the Group's most significant scheme which accounts for over 90 per cent of the defined benefit obligations. Whilst differences in the underlying liability profiles for the remainder of the Group's pension arrangements mean they may exhibit slightly different sensitivities to variations in these assumptions, the sensitivities provided above are indicative of the impact across the Group as a whole.

The inflation assumption sensitivity applies to both the assumed rate of increase in the Consumer Prices Index (CPI) and the Retail Prices Index (RPI), and include the impact on the rate of increase to pensions, both before and after retirement. These pension increases before and after retirement 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 a change in the rate of salary increases. These increases are capped at a maximum of 2 per cent per annum, and have been assumed to increase at this maximum rate in both 2012 and 2013, therefore there is no sensitivity to an increase in this assumption. The Group is currently in formal consultation with the members of its defined benefit pension schemes regarding proposed changes to the way pensionable pay is calculated, which if introduced would reduce the rate of salary increases to zero. If implemented these changes would have the effect of decreasing both the Group's income statement charge and net defined benefit scheme liability.

The life expectancy assumption has been applied by allowing for an increase/decrease in life expectation from age 60 of one year, based upon the approximate weighted average age for each scheme. Whilst this is an approximate approach and will not give the same result as a one year increase in life expectancy at every age, it provides an appropriate indication of the potential impact on the schemes from changes in life expectancy.

There was no change in the methods and assumptions used in preparing the sensitivity analysis from the re-stated prior year.

Asset-liability matching strategies

The main schemes' assets are invested in a diversified portfolio, consisting primarily of debt securities and equities. The investment strategy is not static and will evolve to reflect the structure of liabilities within the schemes. Specific asset-liability matching strategies for each pension plan are independently determined by the responsible governance body for each scheme and in consultation with the employer.

A significant goal of the asset-liability matching strategies adopted by Group schemes is to reduce volatility caused by changes in market expectations of interest rates and inflation. In the main, this is achieved by investing scheme assets in bonds, primarily fixed interest gilts and index linked gilts, and by entering into interest rate and inflation swap arrangements. These investments are structured to take into account the profile of scheme liabilities, and actively managed to reflect both changing market conditions and changes to the liability profile.

The current asset-liability matching strategy has the objective of mitigating approximately 62 per cent (2012: 45 per cent) of the interest rate volatility and 81 per cent (2012: 54 per cent) of the inflation rate volatility of the liabilities.

38 Retirement benefit obligations (continued)

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

	The Group		The Bank	
	2013 Years	2012 Years	**2013 Years**	2012 Years
Duration of the defined benefit obligation	**21**	21	**21**	21
	2013 £m	2012 £m	**2013 £m**	2012 £m
Maturity analysis of benefits expected to be paid				
Benefits expected to be paid within 12 months	**300**	283	**300**	280
Benefits expected to be paid between 1 and 2 years	**261**	247	**261**	244
Benefits expected to be paid between 2 and 5 years	**896**	843	**896**	833
Benefits expected to be paid between 5 and 10 years	**1,978**	1,844	**1,976**	1,816
Benefits expected to be paid between 10 and 15 years	**2,698**	2,530	**2,695**	2,482
Benefits expected to be paid between 15 and 25 years	**7,162**	6,674	**7,150**	6,547
Benefits expected to be paid between 25 and 35 years	**7,735**	7,134	**7,719**	6,985
Benefits expected to be paid between 35 and 45 years	**6,365**	5,822	**6,351**	5,709
Benefits expected to be paid in more than 45 years	**4,689**	4,404	**4,681**	4,331

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 2013 the charge to the income statement in respect of defined contribution schemes was £79 million (2012: £65 million, representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes
The Group operates a number of schemes which provide post-retirement healthcare benefits and concessionary mortgages to certain employees, retired employees and their dependants. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependants) who retired prior to 1 January 1996. The Group has entered into an insurance contract to provide these benefits and a provision has been made for the estimated cost of future insurance premiums payable.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2008; this valuation has been updated to 31 December 2013 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 4.60 per cent (2012: 4.60 per cent).

Movements in the other post-retirement benefits obligation:

	The Group and Company	
	2013 £m	2012 £m
At 1 January	**(77)**	(63)
Exchange and other adjustments	**(1)**	(7)
Insurance premiums paid	**(4)**	5
Charge for the year	**3**	–
At 31 December	**(79)**	(65)

39 Deferred tax

The movement in the net deferred tax balance is as follows:	Group 2013 £m	Group 2012[1] £m	Company 2013 £m	Company 2012[1] £m
Asset (liability) at 1 January				
As previously reported		3,976		(82)
Restatement (notes 1 and 54)		(131)		(144)
Restated	**3,426**	3,845	**(175)**	(226)
Exchange and other adjustments	**(5)**	(16)	**(1)**	(4)
Disposal of businesses (note 53(e))	**164**	–	**–**	–
Income statement (charge) credit (note 14):				
Due to change in UK corporation tax rate	**(408)**	(289)	**24**	26
Other	**(630)**	(81)	**(2)**	(141)
	(1,038)	(370)	**22**	(115)
Amount charged to equity:				
Post-retirement defined benefit scheme remeasurements	**166**	170	**166**	170
Available-for-sale financial assets (note 44)	**(108)**	(120)	**–**	–
Cash flow hedges (note 44)	**143**	(83)	**–**	–
	201	(33)	**166**	170
Asset (liability) at 31 December	**2,748**	3,426	**12**	(175)

[1]Restated – see note 1.

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated balance sheet and takes account of the inability to offset assets and liabilities where there is no legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the table below which splits the deferred tax assets and liabilities by type.

	Group 2013 £m	Group 2012[1] £m	Company 2013 £m	Company 2012[1] £m
Statutory position				
Deferred tax asset	**2,748**	3,495	**12**	–
Deferred tax liability	**–**	(69)	**–**	(175)
Net deferred tax asset (liability)	**2,748**	3,426	**12**	(175)
Tax disclosure				
Deferred tax asset	**3,098**	4,386	**12**	1
Deferred tax liability	**(350)**	(960)	**–**	(176)
Net deferred tax asset (liability)	**2,748**	3,426	**12**	(175)

[1]Restated – see note 1.

The deferred tax charge in the consolidated income statement comprises the following temporary differences:

	2013 £m	2012[1] £m
Accelerated capital allowances	**258**	11
Pensions and other post-retirement benefits	**22**	(123)
Tax on long-term assurance business	**(229)**	(72)
Tax losses carried forward	**(694)**	236
Allowances for impairment losses	**(71)**	(317)
Other temporary differences	**(324)**	(105)
Deferred tax charge in the income statement	**(1,038)**	(370)

[1]Restated – see note 1.

39 Deferred tax (continued)

Deferred tax assets and liabilities are comprised as follows:

	Group		Company	
	2013 £m	2012[1] £m	**2013 £m**	2012[1] £m
Deferred tax assets:				
Allowances for impairment losses	**1**	190	**–**	–
Pensions and other post-retirement benefits	**30**	–	**11**	–
Capital allowance	**39**	–	**–**	–
Other provisions	**–**	48	**–**	–
Available-for-sale asset revaluation	**–**	291	**–**	–
Tax losses carried forward	**2,855**	3,637	**–**	–
Other temporary differences	**173**	220	**1**	1
Total deferred tax assets	**3,098**	4,386	**12**	1

	Group		Company	
	2013 £m	2012[1] £m	**2013 £m**	2012[1] £m
Deferred tax liabilities:				
Pensions and other post-retirement benefits	**–**	(158)	**–**	(176)
Accelerated capital allowances	**–**	(219)	**–**	–
Tax on long-term assurance business	**–**	(81)	**–**	–
Available-for-sale asset revaluation	**(26)**	–	**–**	–
Derivatives	**(217)**	(353)	**–**	–
Effective interest rate	**(18)**	(33)	**–**	–
Other temporary differences	**(89)**	(116)	**–**	–
Total deferred tax liabilities	**(350)**	(960)	**–**	(176)

[1]Restated – see note 1.

The Finance Act 2013 (the Act) was substantively enacted on 2 July 2013. The Act further reduced the main rate of corporation tax to 21 per cent with effect from 1 April 2014 and 20 per cent with effect from 1 April 2015. The change in the main rate of corporation tax from 23 per cent to 20 per cent has resulted in a reduction in the Group's net deferred tax asset at 31 December 2013 of £375 million, comprising the £408 million charge included in the income statement and a £33 million credit included in equity.

Deferred tax assets

Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable. Group companies have recognised a deferred tax asset of £2,855 million for the Group and £nil for the Company (2012: £3,637 million for the Group and £nil for the Company) in relation to trading tax losses carried forward. After reviews of medium-term profit forecasts, the Group considers that there will be sufficient profits in the future against which these losses will be offset.

Deferred tax assets of £140 million for the Group and £nil for the Company (2012: £131 million for the Group and £nil for the Company) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits to offset them. Capital losses can be carried forward indefinitely.

Deferred tax assets of £49 million for the Group and £nil for the Company (2012: £493 million for the Group and £nil for the Company) have not been recognised in respect of trading losses carried forward, arising in overseas companies, as there are limited predicted future trading profits to offset them. Trading losses can be carried forward indefinitely except for losses in the USA which expire after 20 years.

In addition, deferred tax assets have not been recognised in respect of unrelieved foreign tax carried forward as at 31 December 2013 of £39 million for the Group and £nil for the Company (2012: £40 million for the Group and £nil for the Company), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. These tax credits can be carried forward indefinitely.

40 Other provisions

	Provisions for commitments £m	Payment protection insurance £m	Other regulatory provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2013	9	751	308	89	1,157
Exchange and other adjustments	16	–	(26)	(27)	(37)
Provisions applied	–	(507)	(23)	(38)	(568)
Charge for the year	–	740	76	36	852
At 31 December 2013	**25**	**984**	**335**	**60**	**1,404**

Provisions for commitments
Provisions are held in cases where the Group is irrevocably committed to advance additional funds, but where there is doubt as to the customer's ability to meet its repayment obligations.

Payment protection insurance
Following the unsuccessful legal challenge by the BBA against the Financial Services Authority (FSA) and the Financial Ombudsman Service (FOS), the Group made provisions totalling £2,005 million in 2011 and 2012 against the costs of paying redress to customers in respect of past sales of PPI policies, including the related administrative expenses.

During 2013 average monthly customer initiated complaints have continued to fall. Good progress has also been made in the planned proactive mailings. There have been some adverse trends, and a further £740 million has been added to the provision, of which £52 million was at the half year; £220 million in the third quarter and £468 million at the year end which brings the total amount provided to £2,745 million, including anticipated administrative expenses.

The total amount provided for PPI represents the Group's best estimate of the likely future costs, albeit a number of risks and uncertainties remain, in particular complaint volumes, uphold rates, average redress paid, the scope and cost of proactive mailings and remediation. The cost of these factors could differ materially from the Group's estimates and the assumptions underpinning them and could result in a further provision being required.

Key sensitivities are as follows:

- the number of customer initiated complaints received: an increase of 50,000 from the level assumed would increase the provision for redress costs by £70 million;
- average uphold rate per policy: an increase of one percentage point in this assumption would increase the provision by £7 million;
- average redress paid per uphold policy: an increase of £100 in this assumption would increase the provision by £48 million.

Other regulatory provisions
Interest rate hedging products
In June 2012, a number of banks, including the Group, reached agreement with the FSA (now FCA) to carry out a review of sales made since 1 December 2001 of interest rate hedging products (IRHP) to certain small and medium-sized businesses. As at 31 December 2013 Lloyds Banking Group had identified 1,771 sales of IRHPs to customers within scope of the agreement with the FCA which are being reviewed and, where appropriate, redressed. The Group agreed that on conclusion of this review it would provide redress to any in scope customers where appropriate.

The Group provided £139 million in its accounts for the year ended 31 December 2012 for the estimated cost of redress and related administration costs, based on a pilot review that had been conducted at the time. During 2013 a number of additional cases were reviewed, however no additional provision was considered necessary as a result. No provision has been recognised in relation to claims from customers which are not covered by the agreement with the FCA, or incremental claims from customers within the scope of the review. These will be monitored and future provisions will be recognised to the extent an obligation resulting in a probable outflow is identified.

Other regulatory matters
In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and governmental authorities in relation to a range of matters; a provision is held against the costs expected to be incurred as a result of the conclusions reached. In 2013 the provision was increased by a further £60 million, bringing the total amount charged to £110 million of which £17 million had been utilised at 31 December 2013. This increase reflects the Group's assessment of a limited number of matters under discussion, none of which currently is individually considered financially material in the context of the Group.

Vacant leasehold property and other
Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a biannual basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging three years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

41 Subordinated liabilities

	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Preference shares	**–**	–	**–**	–
Preferred securities	**3,178**	3,374	**–**	–
Undated subordinated liabilities	**611**	673	**1,969**	1,997
Dated subordinated liabilities	**7,189**	8,444	**6,272**	7,024
Total subordinated liabilities	**10,978**	12,491	**8,241**	9,021

The movement in subordinated liabilities during the year was as follows:	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
At 1 January	**12,491**	13,613	**9,021**	9,318
Repurchases and redemptions during the year	**(960)**	(649)	**(677)**	–
Foreign exchange and other movements	**(553)**	(473)	**(103)**	(297)
At 31 December	**10,978**	12,491	**8,241**	9,021

These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of the 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 the 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 the 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 the year (2012: none).

Preference shares	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
6% Non-cumulative Redeemable preference shares	**–**	–	**–**	–

Since 2009, the Company has had in issue 100 6% non-cumulative preference shares of £1 each. The shares are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend of 6% per annum; no dividend shall be paid in the event that the directors determine that prudential capital ratios would not be maintained if the dividend were paid. Upon winding up the shares rank equally with any other preference shares issued by the Company.

Preferred securities	Note	Group 2013 £m	Group 2012 £m
6.071% Non-cumulative Perpetual Preferred Securities (US$750 million)		**465**	497
6.85% Non-cumulative Perpetual Preferred Securities (US$1,000 million)	a	**734**	859
6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities (£600 million)		**603**	604
8.117% Non-cumulative Perpetual Preferred Securities (Class A) (£250 million)	a,b	**256**	262
7.754% Non-cumulative Perpetual Preferred Securities (Class B) (£150 million)		**151**	151
7.881% Guaranteed Non-voting Non-cumulative Preferred Securities (£245 million)		**293**	326
7.627% Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities (€415 million)	a,c	**346**	339
4.939% Non-voting Non-cumulative Perpetual Preferred Securities (€750 million)		**34**	34
7.286% Perpetual Regulatory Tier One Securities (Series A) (£150 million)		**150**	151
7.281% Perpetual Regulatory Tier One Securities (Series B) (£150 million)		**146**	151
Total preferred securities		**3,178**	3,374

41 Subordinated liabilities (continued)

Undated subordinated liabilities	Note	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
5.625% Cumulative Callable Fixed to Floating Rate Undated Subordinated Notes callable 2019 (£500 million)		**5**	4	**5**	4
6.071% Undated Subordinated Fixed to Floating Rate Instruments (US$750 million)		**–**	–	**454**	464
4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)		**81**	81	**81**	81
Floating Rate Undated Subordinated Notes (€500 million)		**50**	49	**50**	49
5.375% Undated Fixed to Floating Rate Subordinated Notes (US$1,000 million)		**–**	9	**–**	9
5.125% Undated Subordinated Fixed to Floating Notes (€750 million)		**59**	59	**59**	59
5.75% Undated Subordinated Step-up Notes (£600 million)		**4**	4	**4**	4
6.85% Undated Subordinated Notes (US$1,000 million)		**–**	–	**598**	611
Fixed to Floating Rate Undated Subordinated Notes (£600 million)		**–**	–	**603**	604
6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	a,d	**22**	21	**22**	21
7.5% Undated Subordinated Step-up Notes (£300 million)		**5**	4	**5**	4
8.625% Perpetual Subordinated Notes (£200 million)		**–**	23	**–**	–
Floating Rate Undated Subordinated Step-up Notes (€300 million)	a	**33**	32	**33**	32
Floating Rate Primary Capital Notes (US$250 million)	a	**109**	111	**–**	–
7.375% Subordinated Undated Instruments (£150 million)		**71**	74	**–**	–
4.25% Instruments (¥17 billion)		**109**	138	**–**	–
10.25% Subordinated Undated Instruments (£100 million)		**1**	1	**–**	–
12% Perpetual Subordinated Bonds (£100 million)		**21**	22	**–**	–
8.75% Perpetual Subordinated Bonds (£100 million)		**5**	5	**–**	–
13.625% Perpetual Subordinated Bonds (£75 million)		**14**	14	**–**	–
9.375% Perpetual Subordinated Bonds (£50 million)		**15**	15	**–**	–
5.75% Undated Subordinated Step-up Notes (£500 million)		**7**	7	**7**	7
4.939% Undated Fixed to Floating Rate Subordinated Notes (€750 million)		**–**	–	**34**	34
Undated Perpetual Preferred Securities (£750 million)		**–**	–	**14**	14
Total undated subordinated liabilities		**611**	673	**1,969**	1,997

41 Subordinated liabilities (continued)

Dated subordinated liabilities	Note	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
6.125% Notes 2013 (€325 million)		**–**	280	**–**	–
4.25% Subordinated Guaranteed Notes 2013 (US$1,000 million)		**–**	630	**–**	621
11% Subordinated Bonds 2014 (£250 million)		**275**	276	**–**	–
4.875% Subordinated Notes 2015 (€1,000 million)		**903**	918	**865**	846
Callable Floating Rate Subordinated Notes 2016 (€500 million)	a	**142**	139	**142**	139
Callable Floating Rate Subordinated Notes 2016 (€500 million)	a	**198**	193	**198**	193
Subordinated Callable Notes 2016 (US$750 million)	a	**301**	307	**301**	307
Subordinated Callable Notes 2017 (€1,000 million)	a	**384**	375	**384**	375
Subordinated Callable Notes 2017 (US$1,000 million)	a	**295**	301	**295**	301
Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)	a	**36**	43	**36**	43
6.75% Subordinated Callable Fixed to Floating Rate Instruments 2017 (Aus$200 million)	a	**9**	11	**9**	11
5.109% Callable Fixed to Floating Rate Notes 2017 (Can$500 million)	a	**16**	17	**16**	17
6.305% Subordinated Callable Fixed to Floating Rate Notes 2017 (£500 million)	a	**35**	35	**35**	35
10.5% Subordinated Bonds 2018 (£150 million)		**164**	164	**–**	–
6.75% Subordinated Fixed Rate Notes 2018 (US$2,000 million)		**1,283**	1,365	**1,283**	1,365
6.375% Instruments 2019 (£250 million)		**304**	330	**–**	–
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)		**649**	662	**629**	617
9.375% Subordinated Bonds 2021 (£500 million)		**626**	685	**–**	–
5.374% Subordinated Fixed Rate Notes 2021 (€160 million)		**166**	173	**166**	173
7.07% Subordinated Fixed Rate Notes 2023 (€175 million)		**175**	183	**175**	183
4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)		**646**	670	**646**	670
6.00% Subordinated Notes 2033 (US$750 million)		**582**	687	**453**	463
7.881% Subordinated Extendable Maturity Notes 2048 (£245 million)		**–**	–	**293**	326
Fixed to Floating Rate Subordinated Extendable Maturity Notes 2048 (€415 million)		**–**	–	**346**	339
Total dated subordinated liabilities		**7,189**	8,444	**6,272**	7,024

a) These securities have passed their first call and are callable at specific dates as per the terms of the securities at the option of the issuer and with approval from the PRA.

b) The fixed rate on this security was reset from 8.117 per cent to 6.059 per cent with effect from 31 May 2010.

c) The fixed rate on this security was reset from 7.627 per cent to 3 months Euribor plus 2.875 per cent with effect from 9 December 2011.

d) The fixed rate on this security was reset from 6.05 per cent to 3 months Euribor plus 2.25 per cent with effect from 23 November 2011.

At 31 December 2013 £10,203 million (2012: £11,581 million) of subordinated liabilities of the Group and £8,241 million (2012: £8,400 million) of the Company has a contractual residual maturity of greater than one year.

42 Share capital

(1) Authorised share capital

	Group and Company			
	2013 Number of shares	2012 Number of shares	**2013 £m**	2012 £m
Sterling				
Ordinary shares of 25p	**15,139,999,999**	15,139,999,999	**3,785**	3,785
6.125% non-cumulative redeemable preference shares of £1	**200,000,000**	200,000,000	**200**	200
8.117% non-cumulative perpetual preference shares class 'A' of £10 each	**250,000**	250,000	**3**	3
7.754% non-cumulative perpetual preference shares class 'B' of £10 each	**150,000**	150,000	**2**	2
Preference shares of £1 each	**2,596,834,398**	2,596,834,398	**2,597**	2,597
			6,587	6,587
US dollars			**US$m**	US$m
Preference shares of US$1 each	**4,997,750,000**	4,997,750,000	**4,998**	4,998
Euro			**€m**	€m
Preference shares of €1 each	**3,000,000,000**	3,000,000,000	**3,000**	3,000
Japanese yen			**¥m**	¥m
Preference shares of ¥250 each	**400,000,000**	400,000,000	**100,000**	100,000
Canadian dollars			**CAD$m**	CAD$m
Preference shares of CAD$1 each	**1,000,000,000**	1,000,000,000	**1,000**	1,000
Australian dollars			**AUD$m**	AUD$m
Preference shares of AUD$1 each	**1,000,000,000**	1,000,000,000	**1,000**	1,000

(2) Issued share capital

	Group and Company			
	2013 Number of shares	2012 Number of shares	**2013 £m**	2012 £m
Ordinary shares of 25p each				
At 1 January and 31 December	**15,053,262,841**	15,053,262,841	**3,763**	3,763
Issued and fully paid preference shares				
Preference shares of £1 each				
At 1 January and 31 December	**100**	100	**–**	–
Total share capital at 31 December	**15,053,262,941**	15,053,262,941	**3,763**	3,763

43 Share premium account

	Group and Company	
	2013 £m	2012 £m
At 1 January and 31 December	**18,655**	18,655

44 Other reserves

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Other reserves comprise:				
Merger and other reserves	**10,051**	10,051	**9,537**	9,537
Capital redemption reserve	**141**	141	**141**	141
Revaluation reserve in respect of available-for-sale financial assets	**38**	(125)	**–**	–
Cash flow hedging reserve	**907**	1,237	**–**	(1)
Foreign currency translation reserve	**(98)**	17	**15**	16
At 31 December	**11,039**	11,321	**9,693**	9,693

Movements in other reserves were as follows:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Merger and other reserves				
At 1 January and 31 December	**10,051**	10,051	**9,537**	9,537

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Capital redemption reserve				
At 1 January and 31 December	**141**	141	**141**	141

	Group	
	2013 £m	2012 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**(125)**	(498)
Change in fair value of available-for-sale financial assets	**219**	484
Deferred tax	**(61)**	(107)
Current tax	**3**	(3)
	161	374
Income statement transfers:		
Disposals	**4**	(385)
Deferred tax	**(38)**	74
	(34)	(311)
Impairment	**45**	397
Deferred tax	**(9)**	(87)
	36	310
At 31 December	**38**	(125)

44 Other reserves (continued)

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Cash flow hedging reserve				
At 1 January	**1,237**	859	**(1)**	(1)
Change in fair value of hedging derivatives	**(79)**	730	**–**	–
Deferred tax	**64**	(145)	**–**	–
	(15)	585	**–**	–
Income statement transfers	**(394)**	(269)	**–**	–
Deferred tax	**79**	62	**–**	–
	(315)	(207)	**–**	–
At 31 December	**907**	1,237	**(1)**	(1)

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Foreign currency translation reserve				
At 1 January	**17**	(30)	**16**	16
Currency translation differences arising in the year	**(188)**	(8)	**–**	–
Foreign currency gains (losses) on net investment hedges (tax: £nil)	**73**	55	**–**	–
At 31 December	**(98)**	17	**16**	16

45 Retained profits

	Group		Company	
	2013 £m	2012[1] £m	**2013 £m**	2012[1] £m
At 1 January				
As previously reported		(9,170)		(4,978)
Restatement (notes 1 and 54)		391		431
Restated	**(9,209)**	(8,779)	**(3,849)**	(4,547)
Profit for the year[2]	**1,602**	138	**1,287**	1,242
Dividends paid	**(3,493)**	–	**(3,493)**	–
Value of employee services	**143**	–	**–**	–
Post-retirement defined benefit scheme remeasurement	**(665)**	(568)	**(665)**	(544)
At 31 December	**(11,622)**	(9,209)	**(6,720)**	(3,849)

[1]Restated – see note 1.

[2]No income statement has been prepared for the Company as permitted by section 408 of the Companies Act 2006.

46 Dividends

Dividends of £3,493 million were paid during the year to 31 December 2013 (no dividends were paid on the Company's ordinary shares in 2012).

In November 2009, as part of the restructuring plan that was a requirement for European Commission approval of state aid received by the Lloyds Banking Group, Lloyds Banking Group plc agreed to suspend the payment of coupons and dividends on certain preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. Lloyds Banking Group plc also agreed to temporarily suspend and/or waive dividend payments on certain preference shares which have been issued intra-group. Consequently, in accordance with the terms of some of these instruments, the Company was prevented from making dividend payments on its ordinary shares during this period.

47 Share-based payments

Share-based payment scheme details

During the year ended 31 December 2012 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 plc 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 11), was £143 million (2012: £114 million).

Deferred bonus plans

Bonuses in respect of the performance in 2013 of employees within certain of the Group's bonus plans have been recognised in these financial statements in full. The amounts to be settled in shares are included within the total charge to the income statement detailed above.

Lloyds Banking Group executive share option schemes

The executive share option schemes were long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in August 2005. These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between March 2004 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5.

Performance conditions for executive options

For options granted in 2004

The performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc.

The performance condition was measured over a three year period which commenced at the end of the financial year preceding the grant of the option and continued until the end of the third subsequent year. If the performance condition was not then met, it was measured at the end of the fourth financial year. If the condition was not then met, the options would lapse.

To meet the performance conditions, the Group's ranking against the comparator group was required to be at least ninth. The full grant of options only became exercisable if the Group was ranked first. A performance multiplier (of between nil and 100 per cent) was applied below this level to calculate the number of shares in respect of which options granted to Executive Directors would become exercisable, and were calculated on a sliding scale. If Lloyds Banking Group plc was ranked below median the options would not be exercisable.

Options granted to senior executives other than Executive Directors were not so highly leveraged and, as a result, different performance multipliers were applied to their options. For the majority of executives, options were granted with the performance condition but with no performance multiplier.

Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 14 per cent for Executive Directors, 24 per cent for Managing Directors, and 100 per cent for all other executives.

For options granted in 2005

The same conditions applied as for grants made in 2004, except that:

- the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc;
- if the performance condition was not met at the end of the third subsequent year, the options would lapse; and
- the full grant of options became exercisable only if the Group was ranked in the top four places of the comparator group. A sliding scale applied between fourth and eighth positions. If Lloyds Banking Group was ranked below the median (ninth or below) the options would lapse.

Options granted in 2005 became exercisable as the performance condition was met when tested. The performance condition vested at 82.5 per cent for all options granted.

Movements in the number of share options outstanding under the executive share option schemes during 2012 and 2013 are set out below:

	2013		2012	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**8,044,896**	**224.95**	10,174,869	225.15
Forfeited	**(1,992,303)**	**227.70**	(2,129,973)	225.92
Lapsed	**–**	**–**	–	–
Outstanding at 31 December	**6,052,593**	**224.04**	8,044,896	224.95
Exercisable at 31 December	**6,052,593**	**224.03**	8,044,896	224.95

No options were exercised during 2013 or 2012. The weighted average remaining contractual life of options outstanding at the end of the year was 0.8 years (2012: 1.9 years). The fair values of the executive share options have been determined using a standard Black-Scholes model.

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £250 per month and, at the expiry of a fixed term of three, five or seven years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Group at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

47 Share-based payments (continued)

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

	2013 Number of options	**2013** Weighted average exercise price (pence)	2012 Number of options	2012 Weighted average exercise price (pence)
Outstanding at 1 January	**314,572,023**	**48.01**	453,019,032	49.74
Granted	**510,414,399**	**40.62**	–	–
Exercised	**(294,905,606)**	**46.78**	–	–
Forfeited	**(7,715,717)**	**43.08**	(8,427,262)	49.15
Cancelled	**(10,761,588)**	**45.61**	(88,340,810)	49.83
Expired	**(10,633,894)**	**56.28**	(41,678,937)	62.67
Outstanding at 31 December	**500,969,617**	**41.16**	314,572,023	48.01
Exercisable at 31 December	**2,255,239**	**120.76**	119,141	86.50

The weighted average share price at the time that the options were exercised during 2013 was £0.65. No options were exercised in 2012. The weighted average remaining contractual life of options outstanding at the end of the year was 2.9 years (2012: 0.8 years).

The weighted average fair value of SAYE options granted during 2013 was £0.24. No options were granted in 2012. The fair values of the SAYE options have been determined using a standard Black-Scholes model.

For the HBOS sharesave plan, no options were exercised during 2013 or 2012. The options outstanding at 31 December 2013 had an exercise price of £1.8066 (2012: £1.8066) and a weighted average remaining contractual life of 1.1 years (2012: 2.1 years).

Other share option plans

Lloyds Banking Group Executive Share Plan 2003

The Plan was adopted in December 2003 and under the Plan share options may be granted to senior employees. Options under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions. The Plan's usage has now been extended to not only compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes with, in some instances, the grant being made subject to individual performance conditions.

Participants are not entitled to any dividends paid during the vesting period.

	2013 Number of options	**2013** Weighted average exercise price (pence)	2012 Number of options	2012 Weighted average exercise price (pence)
Outstanding at 1 January	**45,614,150**	**Nil**	53,000,069	Nil
Granted	**9,284,956**	**Nil**	34,345,366	Nil
Exercised	**(16,079,222)**	**Nil**	(41,290,412)	Nil
Forfeited	**(1,290,720)**	**Nil**	(440,873)	Nil
Lapsed	**(174,185)**	**Nil**	–	Nil
Outstanding at 31 December	**37,354,979**	**Nil**	45,614,150	Nil
Exercisable at 31 December	**4,275,432**	**Nil**	3,065,531	Nil

The weighted average fair value of options granted in the year was £0.56 (2012: £0.30). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2013 was £0.55 (2012: £0.33). The weighted average remaining contractual life of options outstanding at the end of the year was 3.6 years (2012: 3.7 years).

Lloyds Banking Group Share Buy Out Awards

As part of arrangements to facilitate the recruitment of certain Executives, options have been granted by individual deed and, where appropriate, in accordance with the Listing Rules of the UK Listing Authority.

The awards were granted in recognition that the Executives' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Group.

Notes to the accounts

47 Share-based payments (continued)

Movements in the number of options outstanding are set out below:

	2013		2012	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**21,321,237**	**Nil**	21,321,237	Nil
Granted	**–**	**Nil**	–	–
Exercised	**(5,953,810)**	**Nil**	–	–
Forfeited	**(4,194,827)**	**Nil**	–	–
Outstanding at 31 December	**11,172,600**	**Nil**	21,321,237	Nil
Exercisable at 31 December	**11,083,749**	**Nil**	16,509,862	Nil

No options were granted in 2013 or 2012. The weighted average remaining contractual life of options outstanding at the end of the year was 7.5 years (2012: 8.6 years).

The weighted average share price at the time the options were exercised during 2013 was £0.75. No options were exercised in 2012.

Participants are entitled to any dividends paid during the vesting period. This amount will be paid in cash unless the Remuneration Committee decides it will be paid in shares.

The fair values of the majority of options granted have been determined using a standard Black-Scholes model. The fair values of the remaining options have been determined by Monte Carlo simulation.

HBOS share option plans
The table below details the outstanding options for the HBOS Share Option Plan and the St James's Place Share Option Plan. The final award under the HBOS Share Option Plan was made in 2004. Under this plan, options over shares, at market value with a face value equal to 20 per cent of salary, were granted to employees with the exception of certain senior executives. A separate option plan exists for some partners of St James's Place, which granted options in respect of Lloyds Banking Group plc shares. The final award under the St James's Place Share Option Plan was made in 2009. Movements in the number of share options outstanding under these schemes are set out below:

During 2013 the Group completed the sale of all of its holding in St James's Place plc, as set out in note 9. The participants of the St James's Place Share Option Plan remain entitled to the Lloyds Banking Group plc shares awarded under the terms of this Plan and these options are included in the table below.

Participants are not entitled to any dividends paid during the vesting period.

	2013		2012	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**19,857,692**	**363.76**	22,058,552	394.30
Exercised	**(2,609,272)**	**51.83**	–	–
Forfeited	**(240,349)**	**568.80**	(319,134)	572.22
Lapsed	**(2,144,026)**	**546.43**	(1,881,726)	686.47
Cancelled	**(1,744,461)**	**532.39**	–	–
Outstanding at 31 December	**13,119,584**	**369.76**	19,857,692	363.76
Exercisable at 31 December	**13,119,584**	**369.76**	19,857,692	363.76

The weighted average share price at the time the options were exercised during 2013 was £0.72. No options were exercised in 2012.

The options outstanding under the HBOS Share Option Plan and St James's Place Share Option Plan at 31 December 2013 had exercise prices in the range of £0.5183 to £5.80 (2012: £0.5183 to £5.80) and a weighted average remaining contractual life of 0.2 years (2012: 1.1 years).

Other share plans
Lloyds Banking Group Long-Term Incentive Plan
The Long-Term Incentive Plan (LTIP) introduced in 2006 is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Group over a three year period. Awards are made within limits set by the rules of the Plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

Participants may be entitled to any dividends paid during the vesting period if the performance conditions are met. An amount equal in value to any dividends paid between the award date and the date the Remuneration Committee determine that the performance conditions were met may be paid, based on the number of shares that vest. The Remuneration Committee will determine if any dividends are to be paid in cash or in shares.

47 Share-based payments (continued)

The performance conditions for awards made in March and August 2010 were as follows:

(i) **EPS:** relevant to 50 per cent of the award. Performance was measured based on EPS growth over a three-year period from the baseline EPS of 2009.

If the absolute improvement in adjusted EPS reached 158 per cent, 25 per cent of this element of the award, being the threshold, would vest. If absolute improvement in adjusted EPS reached 180 per cent, 100 per cent of this element would vest.

Vesting between threshold and maximum would be on a straight line basis.

(ii) **EP:** relevant to 50 per cent of the award. Performance was measured based on the compound annual growth rate of adjusted EP over the three financial years starting on 1 January 2010 relative to an adjusted 2009 EP base.

If the compounded annual growth rate of adjusted EP reached 57 per cent per annum, 25 per cent of this element of the award, being the threshold, would vest. If the compounded annual growth rate of adjusted EP reached 77 per cent per annum, 100 per cent of this element would vest.

Vesting between threshold and maximum would be on a straight line basis.

For awards made to Executive Directors, a third performance condition was set, relating to Absolute Share Price, relevant to 28 per cent of the award. Performance was measured based on the Absolute Share Price on 26 March 2013, being the third anniversary of the award date. If the share price at the end of the performance period was 75 pence or less, none of this element of the award would vest. If the share price was 114 pence or higher, 100 per cent of this element would vest. Vesting between threshold and maximum would be on a straight line basis, provided that shares comprised in the Absolute Share Price element may only be released if both the EPS and EP performance measures had been satisfied at the threshold level or above. The EPS and EP performance conditions each relate to 36 per cent of the total award.

At the end of the performance period for the EPS and EP measures, it was assessed that neither of the performance conditions had been met and the awards did not vest.

The performance conditions for awards made in March and September 2011 are as follows:

(i) **EPS:** relevant to 50 per cent of the award. The performance target is based on 2013 adjusted EPS outcome.

If the adjusted EPS reaches 6.4p, 25 per cent of this element of the award, being the threshold, will vest.

If adjusted EPS reaches 7.8p, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **EP:** relevant to 50 per cent of the award. The performance target is based on 2013 adjusted EP outcome.

If the adjusted EP reaches £567 million, 25 per cent of this element of the award, being the threshold, will vest. If the adjusted EP reaches £1,534 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

For awards made to Executive Directors, a third performance condition was set, relating to Absolute Total Shareholder Return, relevant to one third of the award. Performance will be measured based on the annualised Absolute Total Shareholder Return over the three year performance period. If the annualised Absolute Total Shareholder Return at the end of the performance period is less than 8 per cent, none of this element of the award will vest. If the Absolute Total Shareholder Return is 8 per cent, 25 per cent of this element of the award, being the threshold, will vest. If the Absolute Total Shareholder Return is 14 per cent or higher, 100 per cent of this element will vest. Vesting between threshold and maximum will be on a straight line basis. The EPS and EP performance conditions will each relate to 33.3 per cent of the total award.

At the end of the performance period for the EPS and EP measures, the targets had not been fully met and therefore these awards will vest in 2014 at a rate of 68 per cent (54 per cent for members of the Group Executive Committee, including Executive Directors).

The performance conditions for awards made in March and September 2012 are as follows:

(i) **EP:** relevant to 30 per cent of the award. The performance target is based on 2014 adjusted EP outcome.

If the adjusted EP reaches £225 million, 25 per cent of this element of the award, being the threshold, will vest.

If the adjusted EP reaches £2,330 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **Absolute Total Shareholder Return (ATSR):** relevant to 30 per cent of the award. Performance will be measured against the annualised return over the three year period ending 31 December 2014.

If the ATSR reaches 12 per cent per annum, 25 per cent of this element of the award, being the threshold, will vest.

If the ATSR reaches 30 per cent per annum, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iii) **Short-term funding as a percentage of total funding:** relevant to 10 per cent of the award. Performance will be measured relative to 2014 targets.

If the average percentage reaches 20 per cent, 25 per cent of this element of the award, being the threshold, will vest.

If the average percentage reaches 15 per cent, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

47 Share-based payments (continued)

(iv) **Non-core assets at the end of 2014:** relevant to 10 per cent of the award. Performance will be measured by reference to balance sheet non-core assets at 31 December 2014.

If non-core assets amount to £95 billion or less, 25 per cent of this element of the award, being the threshold, will vest.

If non-core assets amount to £80 billion or less, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(v) **Net Simplification benefits:** relevant to 10 per cent of the award. Performance will be measured by reference to the run rate achieved by the end of 2014.

If a run rate of net Simplification benefits of £1.5 billion is achieved, 25 per cent of this element of the award, being the threshold, will vest.

If a run rate of net Simplification benefits of £1.8 billion is achieved, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(vi) **Customer satisfaction:** relevant to 10 per cent of the award. Performance will be measured by reference to the total number of FSA reportable complaints per 1,000 customers over the three year period to 31 December 2014.

If complaints per 1,000 customers average 1.5 per annum or less over three years, 25 per cent of this element of the award, being the threshold, will vest.

If complaints per 1,000 customers average 1.3 per annum or less over three years, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

The performance conditions for awards made in March and October 2013 are as follows:

(i) **EP:** relevant to 35 per cent of the award. The performance target is based on 2015 adjusted EP outcome.

If the adjusted EP reaches £1,254 million, 25 per cent of this element of the award, being the threshold, will vest.

If the adjusted EP reaches £1,881 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **Absolute Total Shareholder Return (ATSR):** relevant to 30 per cent of the award. Performance will be measured against the annualised return over the three year period ending 31 December 2015.

If the ATSR reaches 8 per cent per annum, 25 per cent of this element of the award, being the threshold, will vest.

If the ATSR reaches 16 per cent per annum, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iii) **Adjusted total costs:** relevant to 10 per cent of the award. The performance target is based on 2015 adjusted total costs.

If adjusted total costs are £9,323 million or less, 25 per cent of this element of the award, being the threshold, will vest.

If adjusted total costs are £8,973 million or less, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(iv) **Non-core assets (excluding UK Retail) at the end of 2015:** relevant to 10 per cent of the award. Performance will be measured by reference to balance sheet non-core assets at 31 December 2015.

If non-core assets amount to £37 billion or less, 25 per cent of this element of the award, being the threshold, will vest.

If non-core assets amount to £28 billion or less, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(v) **Customer satisfaction:** relevant to 10 per cent of the award. Performance will be measured by reference to the total number of FCA reportable complaints per 1,000 customers over the three year period to 31 December 2015.

If complaints per 1,000 customers average 1.05 per annum or less over three years, 25 per cent of this element of the award, being the threshold, will vest.

If complaints per 1,000 customers average 0.95 per annum or less over three years, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(vi) **SME lending:** relevant to 5 per cent of the award. Performance will be measured by reference to the movement in lending to SMEs relative to the market as reported by the Bank of England over the three year period ending 31 December 2015.

If the movement in SME lending equates to the market movement, 25 per cent of this element of the award, being the threshold, will vest.

If the movement in SME lending is 4 per cent or more greater than the market movement, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

47 Share-based payments (continued)

In addition, short-term funding must remain within that stated in the Group's Risk Appetite throughout the three year period to 31 December 2015.

	2013 Number of shares	2012 Number of shares
Outstanding at 1 January	**515,951,517**	543,738,186
Granted	**186,360,995**	265,011,679
Vested	**–**	(71,591,014)
Forfeited	**(153,426,617)**	(221,207,334)
Outstanding at 31 December	**548,885,895**	515,951,517

The weighted average fair value of the share awards granted in 2013 was £0.34 (2012: £0.24). The fair values of the majority of share awards granted have been determined using a standard Black-Scholes model. The fair values of the remaining share awards have been determined by Monte Carlo simulation.

Scottish Widows Investment Partnership Long-Term Incentive Plan

The Scottish Widows Investment Partnership (SWIP) Long-Term Incentive Plan applicable to senior executives and employees of SWIP, which had previously been a cash-only scheme, was amended in May 2012 for awards granted on or after that date. The amendment introduced the receipt of shares in Lloyds Banking Group plc as an element of the total award. For awards made in June 2012, the other element continued to be cash-based, with the split between cash-based and share-based determined by the Remuneration Committee. Awards made in June 2013 were fully share-based. The amendment is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of SWIP over a three year period. Awards are made within limits set by the rules of the Plan, with the maximum limits for combined cash and shares awarded equating to 3.5 times annual salary. In exceptional circumstances this may increase to 4 times annual salary.

The performance conditions for share-based awards made in June 2012 are as follows:

(i) **Profitability:** relevant to 40 per cent of the award. The performance target is based on a cumulative 3 year profit before tax. If cumulative profit before tax reaches a specified target level, 100 per cent of this element will vest. If cumulative profit before tax reaches 90 per cent of the target level, 25 per cent of this element of the award, being the threshold, will vest. If cumulative profit before tax reaches 110 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(ii) **Investment performance:** relevant to 40 per cent of the award. The performance target is based on the percentage of SWIP funds achieving at or above benchmark performance (on a competitor median or index basis) over the 3 year period. If 50 per cent of funds exceed benchmark performance, 25 per cent of this element of the award, being the threshold, will vest. If 55 per cent of funds exceed benchmark performance, 100 per cent of this element, being the target, will vest. If 70 per cent of funds exceed benchmark performance, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(iii) **Funds under management (FUM) growth:** relevant to 20 per cent of the award. The performance target is based on growth in the value of third party assets managed by SWIP by the end of the 3 year period. If third party FUM reaches a specified target level, 100 per cent of this element of the award will vest. If third party FUM reaches 80 per cent of the target level, 25 per cent of this element, being the threshold, will vest. If third party FUM reaches 120 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

For awards made to SWIP's Code Staff (as defined by FSA), a fourth performance condition was set, relating to an internal measure of operational risk. This additional measure is relevant to 15 per cent of the award for these individuals, with a corresponding 5 per cent reduction in each of the weightings for the other three measures described above. As with the other measures, this performance condition has a target value at which 100 per cent of the award will vest, a maximum value at which 200 per cent of the award will vest, and a threshold value at which 25 per cent of the award will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

The relevant period commenced on 1 January 2012 and ends on 31 December 2014.

The performance conditions for share-based awards made in June 2013 are as follows:

(i) **Profitability:** relevant to 35 per cent of the award. The performance target is based on a cumulative 3 year profit before tax. If cumulative profit before tax reaches a specified target level, 100 per cent of this element will vest. If cumulative profit before tax reaches 80 per cent of the target level, 25 per cent of this element of the award, being the threshold, will vest. If cumulative profit before tax reaches 120 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(ii) **Investment performance:** relevant to 35 per cent of the award. The performance target is based on the percentage of SWIP funds achieving at or above benchmark performance (on a competitor median or index basis) over the 3 year period. If 50 per cent of funds exceed benchmark performance, 25 per cent of this element of the award, being the threshold, will vest. If 55 per cent of funds exceed benchmark performance, 100 per cent of this element, being the target, will vest. If 70 per cent of funds exceed benchmark performance, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

47 Share-based payments (continued)

(iii) **Funds under management (FUM) growth:** relevant to 15 per cent of the award. The performance target is based on growth in the value of third party assets managed by SWIP by the end of the 3 year period. If third party FUM reaches a specified target level, 100 per cent of this element of the award will vest. If third party FUM reaches 80 per cent of the target level, 25 per cent of this element, being the threshold, will vest. If third party FUM reaches 120 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

(iv) **Risk:** relevant to 15 per cent of the award. The performance target is based on a cumulative three year risk score. If the cumulative risk score reaches a specified target level, 100 per cent of this element will vest. If the cumulative risk score reaches 120 per cent of the target level, 25 per cent of this element of the award, being the threshold, will vest. If the cumulative risk score is 80 per cent of the target level, 200 per cent of this element of the award, being the maximum, will vest.

No award will be made where performance is below the threshold. Vesting between threshold and target and between target and maximum will be on a straight line basis.

The relevant period commenced on 1 January 2013 and ends on 31 December 2015.

	2013 Number of shares	2012 Number of shares
Outstanding at 1 January	**5,452,877**	–
Granted	**10,331,924**	5,452,877
Outstanding at 31 December	**15,784,801**	5,452,877

The fair value of the share awards granted in 2013 was £0.43. The fair values of share awards granted have been determined using a standard Black-Scholes model.

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding for the option schemes were as follows:

	Executive schemes			**SAYE schemes**			**Other share option plans**		
	Weighted average exercise price (pence)	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**
At 31 December 2013									
Exercise price range									
£0 to £1	**–**	**–**	**–**	**40.63**	**2.91**	**499,088,383**	**5.25**	**4.1**	**51,528,728**
£1 to £2	**199.91**	**0.6**	**196,201**	**180.64**	**1.09**	**1,881,234**	**–**	**–**	**–**
£2 to £3	**224.85**	**0.8**	**5,856,392**	**–**	**–**	**–**	**–**	**–**	**–**
£5 to £6	**–**	**–**	**–**	**–**	**–**	**–**	**580.00**	**0.2**	**7,897,324**

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
At 31 December 2012									
Exercise price range									
£0 to £1	–	–	–	46.79	0.8	311,648,405	5.43	4.9	74,766,919
£1 to £2	199.91	1.6	233,714	178.14	1.8	2,923,618	–	–	–
£2 to £3	225.69	1.9	7,811,182	–	–	–	–	–	–
£3 to £4	–	–	–	–	–	–	–	–	–
£5 to £6	–	–	–	–	–	–	566.89	0.9	12,026,160

47 Share-based payments (continued)

The fair value calculations at 31 December 2013 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Save-As-You-Earn	Executive Share Plan 2003	LTIP	SWIP LTIP
Weighted average risk-free interest rate	**0.33%**	**0.37%**	**0.31%**	**0.30%**
Weighted average expected life	**3.1 years**	**1.0 years**	**3.0 years**	**3.0 years**
Weighted average expected volatility	**45%**	**35%**	**45%**	**45%**
Weighted average expected dividend yield	**2.5%**	**2.5%**	**4.3%**	**4.4%**
Weighted average share price	**£0.51**	**£0.57**	**£0.49**	**£0.49**
Weighted average exercise price	**£0.41**	**Nil**	**Nil**	**Nil**

Expected volatility is a measure of the amount by which the Group's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in the Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Share incentive plan

Free shares

An award of shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000. The percentage is normally announced concurrently with the Group's annual results and the price of the shares awarded is announced at the time of award. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

The last award of free shares was made in 2008.

Matching shares

The Group undertakes to match shares purchased by employees up to the value of £30 per month; these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

The number of shares awarded relating to matching shares in 2013 was 19,870,495 (2012: 36,158,343), with an average fair value of £0.63 (2012: £0.34), based on market prices at the date of award.

48 Related party transactions

Key management personnel
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity. At 31 December 2013, 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 which has been allocated to the Company on an estimated basis.

	2013 £m	2012 £m
Compensation		
Salaries and other short-term benefits	8	6
Post-employment benefits	–	–
Share-based payments	11	7
Total compensation	19	13

The aggregate of the emoluments of the directors was £7.4 million (2012: £7.6 million).

Aggregate company contributions in respect of directors to defined contribution pension schemes were £0.2 million (2012: 0.1 million).

The total for the highest paid director (António Horta-Osório) was £3,271,000, (2012: (António Horta-Osório) £3,397,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in either year.

	2013 million	2012 million
Share options over Lloyds Banking Group plc shares		
At 1 January	25	22
Granted (includes entitlement of appointed key management personnel)	5	8
Exercised/lapsed (includes entitlements of former key management personnel)	(16)	(5)
At 31 December	14	25

	2013 million	2012 million
Share incentive plans settled in Lloyds Banking Group plc shares		
At 1 January	70	58
Granted (includes entitlements of appointed key management personnel)	42	45
Exercised/lapsed (includes entitlements of former key management personnel)	(7)	(33)
At 31 December	105	70

48 Related party transactions (continued)

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between the Lloyds Banking Group and its key management personnel:

	2013 £m	2012 £m
Loans		
At 1 January	**2**	3
Advanced (includes loans of appointed key management personnel)	**2**	3
Repayments (includes loans of former key management personnel)	**(2)**	(4)
At 31 December	**2**	2

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 2.5 per cent and 23.9 per cent in 2013 (2012: 2.5 per cent and 29.95 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2012: £nil).

	2013 £m	2012 £m
Deposits		
At 1 January	**10**	6
Placed (includes deposits of appointed key management personnel)	**29**	39
Withdrawn (includes deposits of former key management personnel)	**(26)**	(35)
At 31 December	**13**	10

Deposits placed by key management personnel attracted interest rates of up to 2.9 per cent in 2013 (2012: 3.8 per cent).

At 31 December 2013, the Group did not provide any guarantees in respect of key management personnel (2012: none).

At 31 December 2013, transactions, arrangements and agreements entered into by the Lloyds Banking Group's banking subsidiaries with directors and connected persons of the Group included amounts outstanding in respect of loans and credit card transactions of £1 million with six directors and five connected persons. (2012: £1 million with five directors and three connected persons).

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 has a significant number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Company as follows:

	2013 £m	2012 £m
Assets, included within:		
Amounts owed by Group entities	**28,463**	33,476
Derivative financial instruments	**1,213**	1,565
	29,676	35,041
Liabilities, included within:		
Amounts owed to Group entities	**16,485**	22,619
Subordinated liabilities	**2,295**	2,940
	18,780	25,559

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 2013 the Company earned interest income on the above asset balances of £916 million (2012: £1,189 million) and incurred interest expense on the above liability balances of £309 million (2012: £297 million).

48 Related party transactions (continued)

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:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Assets included within:				
Derivative financial instruments	**9,867**	6,803	**–**	–
Loans and receivables	**193,874**	145,247	**5,251**	6,713
Trading and other financial assets at fair value through profit or loss	**–**	14,977	**–**	–
Other	**76**	3,181	**76**	2,524
	203,817	170,208	**5,327**	9,237
Liabilities included within:				
Deposits from banks and customers	**220,738**	176,870	**6,213**	7,034
Derivative financial instruments	**8,801**	7,601	**–**	–
Subordinated liabilities	**433**	415	**6**	15
Trading financial liabilities	**–**	8,479	**–**	–
Other liabilities	**861**	1,853	**–**	–
	230,833	195,218	**6,219**	7,049

These balances include Lloyds Banking Group plc's banking arrangements and, 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 2013 the Group earned £1,465 million and the Company earned £75 million of interest income on the above asset balances (2012: Group £1,427 million; Company £153 million); the Group incurred £2,475 million and the Company incurred £189 million of interest expense on the above liability balances (2012: Group £2,549 million; Company £335 million).

In July 2011, as a result of a restructuring of the insurance operations of the Lloyds Banking Group, the life, pensions and general insurance subsidiaries of the Group were sold to fellow subsidiaries of the Lloyds Banking Group. Further details are provided in note 25.

UK Government
In January 2009, the UK Government through HM Treasury became a related party of Lloyds Banking Group plc, the Company's ultimate parent company, following its subscription for ordinary shares issued under a placing and open offer. At 31 December 2013, HM Treasury held a 32.7 per cent (31 December 2012: 39.2 per cent) interest in Lloyds Banking Group plc's ordinary share capital and consequently HM Treasury remained a related party of the Company during the year ended 31 December 2013; this percentage holding has reduced from 39.2 per cent at 31 December 2012 following the UK Government's sale of 4,282 million shares on 17 September 2013 and the impact of issues of ordinary shares.

From 1 January 2011, in accordance with IAS 24, UK Government-controlled entities became related parties of the Group. The Group regards the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

Since 31 December 2012, the Group has had the following significant transactions with the UK Government or UK Government-related entities:

During the year ended 31 December 2013, the Lloyds Banking Group participated in a number of schemes operated by the UK Government and central banks and made available to eligible banks and building societies.

National Loan Guarantee Scheme
The Lloyds Banking Group has participated in the UK Government's National Loan Guarantee Scheme, which was launched on 20 March 2012. Through the scheme, the Lloyds Banking Group is providing eligible UK businesses with discounted funding, subject to continuation of the scheme and its financial benefits, and based on the Lloyds Banking Group's existing lending criteria. Eligible businesses who have taken up the funding benefit from a 1 per cent discount on their funding rate for a certain period of time.

Business Growth Fund
In May 2011, the Lloyds Banking Group agreed, together with The Royal Bank of Scotland plc (and three other non-related parties), to commit up to £300 million of equity investment by subscribing for shares in the Business Growth Fund plc which is the company created to fulfil the role of the Business Growth Fund as set out in the British Bankers' Association's Business Taskforce Report of October 2010. At 31 December 2013, the Lloyds Banking Group had invested £64 million (2012: £50 million) in the Business Growth Fund and carried the investment at a fair value of £52 million (2012: £44 million).

Big Society Capital
In January 2012, the Lloyds Banking Group agreed, together with The Royal Bank of Scotland plc (and two other non-related parties), to commit up to £50 million each of equity investment into the Big Society Capital Fund. The Fund, which was created as part of the Project Merlin arrangements, is a UK social investment fund. The Fund was officially launched on 3 April 2012 and the Lloyds Banking Group had invested £12 million in the Fund by 31 December 2012 and invested a further £11 million during the year ended 31 December 2013.

Funding for Lending
In August 2012, the Lloyds Banking Group announced its support for the UK Government's Funding for Lending Scheme and confirmed its intention to participate in the scheme. The Funding for Lending Scheme represents a further source of cost effective secured term funding available to the Lloyds Banking Group. The initiative supports a broad range of UK-based customers, providing householders with more affordable housing finance and businesses with cheaper finance to invest and grow. In November 2013, the Lloyds Banking Group entered into extension letters with the Bank of England to take part in the extension of the Funding for Lending Scheme until the end of January 2015. The extension of the Funding for Lending Scheme focuses on providing businesses with

48 Related party transactions (continued)

cheaper finance to invest and grow. At 31 December 2013, the Lloyds Banking Group had drawn down £8.0 billion under the Funding for Lending Scheme. A further £2.2 billion was drawn in January 2014, which under the Funding for Lending rules counts as funding from the 2013 scheme capacity. This figure includes £0.2 billion drawn by Sainsbury's Bank plc. As a result of the Lloyds Banking Group's holding in the joint venture, Sainsbury's Bank plc was part of the Lloyds Banking Group for Funding for Lending purposes for the period to 31 January 2014.

Help to Buy
On 7 October 2013, Bank of Scotland plc entered into an agreement with The Commissioners of Her Majesty's Treasury by which it agreed that the Halifax Division of Bank of Scotland plc would participate in the Help to Buy Scheme with effect from 11 October 2013 and that Lloyds Bank plc would participate from 3 January 2014. The Help to Buy Scheme is a scheme promoted by the Government and is aimed to encourage participating lenders to make mortgage loans available to customers who require higher loan-to-value mortgages. Halifax and Lloyds are currently participating in the Scheme whereby customers borrow between 90 per cent and 95 per cent of the purchase price.

In return for the payment of a commercial fee, HM Treasury has agreed to provide a guarantee to the lender to cover a proportion of any loss made by the lender arising from a higher loan-to-value loan being made. By 31 December 2013, £79 million had been advanced under this scheme.

Central bank facilities
In the ordinary course of business, the Lloyds Banking Group may from time to time access market-wide facilities provided by central banks.

Other government-related entities
Other than the transactions referred to above, there were no other significant transactions with the UK Government and UK Government-controlled entities (including UK Government-controlled banks) during the period that were not made in the ordinary course of business or that were unusual in their nature or conditions.

Other related party disclosures
St. James's Place plc
In March 2013, the Group sold 102 million shares in St. James's Place plc; fees totalling some £5 million in relation to the sale were settled by St. James's Place plc.

Pension Funds
At 31 December 2013 there were customer deposits of £17 million (2012: £25 million) and investment and insurance contract liabilities of £181 million (2012: £474 million) related to the Group's pension arrangements.

Collective investment vehicles
The Group no longer manages collective investment vehicles such as Open Ended Investment Companies (OEICs). In 2012 the Group managed 32 collective investment vehicles and of these 25 were consolidated. During 2012 the Group invested £505 million and redeemed £146 million in the unconsolidated collective investment vehicles and had investments, at fair value, of £1,503 million at 31 December 2012. The Group earned fees of £60 million during 2012 from the unconsolidated collective investment vehicles.

Joint ventures and associates
The Group provides both administration and processing services to its principal joint venture, Sainsbury's Bank plc. The amounts receivable by the Group during the year were £35 million (2012: £32 million), of which £10 million is outstanding at the year end (2012: £16 million). At 31 December 2013, Sainsbury's Bank plc also had balances with the Group that were included in loans and advances to banks of £806 million (2012: £1,229 million) and deposits by banks of £927 million (2012: £1,268 million).

At 31 December 2013 there were loans and advances to customers of £4,448 million (2012: £3,424 million) outstanding and balances within customer deposits of £70 million (2012: £45 million) relating to joint ventures and associates.

The Group has a number of associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2013, these companies had total assets of approximately £3,514 million (2012: £6,309 million), total liabilities of approximately £3,726 million (2012: £6,151 million) and for the year ended 31 December 2013 had turnover of approximately £2,858 million (2012: £4,035 million) and made a net loss of approximately £83 million (2012: net loss of £535 million). In addition, the Group has provided £2,027 million (2012: £3,602 million) of financing to these companies on which it received £68 million (2012: £116 million) of interest income in the year.

49 Contingent liabilities and commitments

Interchange fees
On 24 May 2012, the General Court of the European Union (the General Court) upheld the European Commission's 2007 decision that an infringement of EU competition law had arisen from arrangements whereby MasterCard issuers charged a uniform fallback multilateral interchange fee (MIF) in respect of cross border transactions in relation to the use of a MasterCard or Maestro branded payment card.

MasterCard has appealed the General Court's judgment to the Court of Justice of the European Union. MasterCard is supported by several card issuers, including Lloyds Banking Group. Judgment is not expected until the summer of 2014 or later.

In parallel:

- the European Commission is also considering further action, and has proposed legislation to regulate interchange fees, following its 2012 Green Paper (Towards an integrated European market for cards, internet and mobile payments) consultation;
- the European Commission has consulted on commitments proposed by VISA to settle an investigation into whether arrangements adopted by VISA for the levying of the MIF in respect of cross-border credit card payment transactions also infringe European Union competition laws. VISA has proposed inter alia to reduce the level of interchange fees on cross-border credit card transactions to the interim level (30 basis points) also agreed by MasterCard. VISA has previously reached an agreement (which expires in 2014) with the European Commission to reduce the level of interchange fees for cross-border debit card transactions to the interim levels agreed by MasterCard;
- the Office of Fair Trading (OFT) has placed on hold its examination of whether the levels of interchange fees paid by retailers in respect of MasterCard and VISA credit cards, debit cards and charge cards in the UK infringe competition law. The OFT has placed the investigation on hold pending the outcome of the MasterCard appeal to the Court of Justice of the European Union; and

49 Contingent liabilities and commitments (continued)

– the UK Government held a consultation in 2013, Opening Up UK Payments. The consultation included a proposal to legislate to introduce a new economic regulator with responsibility for payment systems, including three and four party card schemes, and a role in setting or approving interchange fees.

The ultimate impact of the investigations and any regulatory or legislative developments on the Lloyds Banking Group can only be known at the conclusion of these investigations and any relevant appeal proceedings and once regulatory or legislative proposals are more certain.

Interbank offered rate setting investigations
A number of government agencies in the UK, US and elsewhere, including the UK Financial Conduct Authority, the Serious Fraud Office, the US Commodity Futures Trading Commission, the US Securities and Exchange Commission, the US Department of Justice and a number of State Attorneys General, as well as the European and Swiss Competition Commissions, are conducting investigations into submissions made by panel members to the bodies that set various interbank offered rates including the BBA London Interbank Offered Rates (LIBOR) and the European Banking Federation's Euribor, along with other reference rates. Certain Lloyds Banking Group companies were (at the relevant times) and remain members of various panels whose members make submissions to these bodies including the BBA LIBOR panels. No Lloyds Banking Group company is or was a member of the Euribor panel. Certain Lloyds Banking Group companies have received subpoenas and requests for information from certain government agencies and the Lloyds Banking Group is co-operating with their investigations.

Certain Lloyds Banking Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar LIBOR. The claims have been asserted by plaintiffs claiming to have had an interest in various types of financial instruments linked to US Dollar LIBOR. The allegations in these cases, the majority of which have been coordinated for pre-trial purposes in multi-district litigation proceedings (MDL) in the US District Court for the Southern District of New York (the 'District Court'), are substantially similar to each other. The lawsuits allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act (RICO) and the Commodity Exchange Act (CEA), as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims have been dismissed by the District Court, various motions directed to the sufficiency of their pleading of certain claims are still pending, and many of these cases have been stayed by order of the District Court.

The Lloyds Banking Group is also reviewing its activities in relation to the setting of certain foreign exchange daily benchmark rates, following the FCA's publicised initiation of an investigation into other financial institutions in relation to this activity. In addition, the Lloyds Banking Group, together with a number of other banks, has been named as a defendant in several actions in the District Court, in which the plaintiffs allege that the defendants manipulated WM/Reuters foreign exchange rates in violation of US antitrust laws. The time-frame for the Lloyds Banking Group and the other defendants to move to dismiss these claims has not yet been set.

It is currently not possible to predict the scope and ultimate outcome on the Lloyds Banking Group of the various regulatory investigations, 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.

Financial Services Compensation Scheme
The Financial Services Compensation Scheme (FSCS) is the UK's independent statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable or likely to be unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. Although the substantial majority of this loan, which totalled approximately £17 billion at 31 March 2013, will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. In July 2013, the FSCS confirmed that it expects to raise compensation costs levies of approximately £1.1 billion on all deposit-taking participants over a three year measurement period from 2012 to 2014 to enable it to repay the balance of the HM Treasury loan which matures in 2016. The Group has provided for its share of the 2012 and 2013 element of the levy. The amount of future compensation costs levies payable by the Group depends on a number of factors including participation in the market at 31 December, the level of protected deposits and the population of deposit-taking participants.

Investigation into Bank of Scotland and report on HBOS
The FSA's enforcement investigation into Bank of Scotland plc's Corporate division between 2006 and 2008 concluded with the publication of a Final Notice on 9 March 2012. No financial penalty was imposed on the Group or Bank of Scotland plc. On 12 September 2012 the FSA confirmed it was starting work on a public interest report on HBOS. That report is currently expected to be published in 2014.

US shareholder litigation
In November 2011, the Lloyds Banking Group and two former members of the Lloyds Banking Group's Board of Directors were named as defendants in a purported securities class action filed in the United States District Court for the Southern District of New York. The complaint asserted claims under the Securities Exchange Act of 1934 in connection with alleged material omissions from statements made in 2008 in connection with the acquisition of HBOS. In October 2012 the court dismissed the complaint. The plaintiff's appeal against this decision was dismissed on 19 September 2013 and the time limit for further appeals expired in December 2013.

Tax authorities
The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. The 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 the second half of 2013 HMRC informed the Lloyds Banking Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities of approximately £600 million and a reduction in the Lloyds Banking Group's deferred tax asset of approximately £400 million (overall impact on the Group of approximately £400 million). The Lloyds Banking Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

Other legal actions and regulatory matters
In addition, during the ordinary course of business the Lloyds Banking Group is subject to other threatened and actual legal proceedings (including class or group action claims brought on behalf of customers, shareholders or other third parties), and regulatory challenges, investigations and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Lloyds Banking Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be

49 Contingent liabilities and commitments (continued)

made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed properly to assess the merits of the case and no provisions are held against such matters. However the Lloyds Banking Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

Contingent liabilities and commitments arising from the banking business
Acceptances and endorsements arise where the Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, where the Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction-related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

The Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

	Group	
	2013 £m	2012 £m
Contingent liabilities		
Acceptances and endorsements	**2**	2
Other:		
Other items serving as direct credit substitutes	**23**	28
Performance bonds and other transaction-related contingencies	**267**	565
	290	593
Total contingent liabilities	**292**	595

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

	Group	
	2013 £m	2012 £m
Commitments		
Documentary credits and other short-term trade-related transactions	**4**	4
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**8,214**	6,346
Other commitments	**19,756**	20,828
	27,970	27,174
1 year or over original maturity	**3,962**	7,664
Total commitments	**31,936**	34,842

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £13,537 million (2012: £12,922 million) was irrevocable.

Operating lease commitments
Where a Group company is the lessee the future minimum lease payments under non-cancellable premises operating leases were as follows:

	2013 £m	2012 £m
Not later than 1 year	**111**	133
Later than 1 year and not later than 5 years	**369**	446
Later than 5 years	**566**	680
Total operating lease commitments	**1,046**	1,259

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

Capital commitments

Excluding commitments of the Group in respect of investment property (see note 24), there was no capital expenditure contracted but not provided for at 31 December 2013 (2012: £nil).

50 Financial instruments

(1) Measurement basis of financial assets and liabilities

The accounting policies in note 2 describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

Group	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2013								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	7,369	–	7,369
Items in the course of collection from banks	–	–	–	–	–	217	–	217
Trading and other financial assets at fair value through profit or loss	–	37,084	233	–	–	–	–	37,317
Derivative financial instruments	5,635	15,256	–	–	–	–	–	20,891
Loans and receivables:								
Loans and advances to banks	–	–	–	–	2,100	–	–	2,100
Loans and advances to customers	–	–	–	–	283,638	–	–	283,638
Debt securities	–	–	–	–	529	–	–	529
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	193,874	–	–	193,874
	–	–	–	–	480,141	–	–	480,141
Available-for-sale financial assets	–	–	–	3,333	–	–	–	3,333
Total financial assets	5,635	52,340	233	3,333	480,141	7,586	–	549,268
Financial liabilities								
Deposits from banks	–	–	–	–	–	3,175	–	3,175
Customer deposits	–	–	–	–	–	206,568	–	206,568
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	220,738	–	220,738
Items in course of transmission to banks	–	–	–	–	–	262	–	262
Trading liabilities	–	36,624	–	–	–	–	–	36,624
Derivative financial instruments	2,934	16,203	–	–	–	–	–	19,137
Notes in circulation	–	–	–	–	–	1,176	–	1,176
Debt securities in issue	–	–	–	–	–	29,462	–	29,462
Financial guarantees	–	–	17	–	–	–	–	17
Subordinated liabilities	–	–	–	–	–	10,978	–	10,978
Total financial liabilities	2,934	52,827	17	–	–	472,359	–	528,137

50 Financial instruments (continued)

Group	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2012[1]								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	6,112	–	6,112
Items in the course of collection from banks	–	–	–	–	–	416	–	416
Trading and other financial assets at fair value through profit or loss	–	32,201	31,470	–	–	–	–	63,671
Derivative financial instruments	9,923	25,932	–	–	–	–	–	35,855
Loans and receivables:								
Loans and advances to banks	–	–	–	–	4,874	–	–	4,874
Loans and advances to customers	–	–	–	–	303,622	–	–	303,622
Debt securities	–	–	–	–	3,813	–	–	3,813
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	145,247	–	–	145,247
	–	–	–	–	457,556	–	–	457,556
Available-for-sale financial assets	–	–	–	6,052	–	–	–	6,052
Total financial assets	9,923	58,133	31,470	6,052	457,556	6,528	–	569,662
Financial liabilities								
Deposits from banks	–	–	–	–	–	7,114	–	7,114
Customer deposits	–	–	–	–	–	205,269	–	205,269
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	176,870	–	176,870
Items in course of transmission to banks	–	–	–	–	–	518	–	518
Trading liabilities	–	33,610	–	–	–	–	–	33,610
Derivative financial instruments	4,487	27,223	–	–	–	–	–	31,710
Notes in circulation	–	–	–	–	–	1,198	–	1,198
Debt securities in issue	–	–	–	–	–	49,521	–	49,521
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	423	423
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	27,166	27,166
Financial guarantees	–	–	14	–	–	–	–	14
Subordinated liabilities	–	–	–	–	–	12,491	–	12,491
Total financial liabilities	4,487	60,833	14	–	–	452,981	27,589	545,904

[1]Restated – see note 1.

Company	**Derivatives designated as hedging instruments £m**	**Loans and receivables £m**	**Held at amortised cost £m**	**Total £m**
At 31 December 2013				
Financial assets				
Derivative financial instruments	**1,213**	**–**	**–**	**1,213**
Loans and receivables:				
Amounts due from fellow Lloyds Banking Group undertakings	**–**	**33,790**	**–**	**33,790**
Total financial assets	**1,213**	**33,790**	**–**	**35,003**
Financial liabilities				
Derivative financial instruments	**4**	**–**	**–**	**4**
Subordinated liabilities	**–**	**–**	**8,241**	**8,241**
Total financial liabilities	**4**	**–**	**8,241**	**8,245**

50 Financial instruments (continued)

Company	Derivatives designated as hedging instruments £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2012				
Financial assets				
Derivative financial instruments	1,565	–	–	1,565
Loans and receivables:				
Amounts due from fellow Lloyds Banking Group undertakings	–	42,713	–	42,713
Total financial assets	1,565	42,713	–	44,278
Financial liabilities				
Derivative financial instruments	10	–	–	10
Subordinated liabilities	–	–	9,021	9,021
Total financial liabilities	10	–	9,021	9,031

Interest rate risk and currency risk
The Company is exposed to interest rate risk and currency risk on its subordinated debt.

The Company has entered into interest rate and currency swaps with its subsidiary, Bank of Scotland plc, to manage these risks.

Credit risk
The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiary and subsidiaries of that company.

(2) Reclassification of financial assets
No assets were reclassified in 2013 or 2012.

In accordance with the amendment to IAS 39 that became applicable during 2008, the Group reviewed the categorisation of its financial assets classified as held for trading and available-for-sale. On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, the Group reclassified the following financial assets:

- In January 2009, the Group reclassified £1,825 million of debt securities classified as held for trading to debt securities classified as loans and receivables.
- In addition, the Group reclassified £649 million of securities classified as available-for-sale to debt securities classified as loans and receivables.
- With effect from 1 July 2008, the Group transferred £12,210 million of assets previously classified as held for trading into available-for-sale financial assets.
- With effect from 1 November 2008, the Group transferred £35,446 million of assets previously classified as available-for-sale financial assets into loans and receivables.

At the time of these transfers, the Group had the intention and ability to hold them for the foreseeable future or until maturity. As at the date of reclassification, the weighted average effective interest rate of the assets transferred was 0.7 per cent to 9.5 per cent with the estimated recoverable cash flows of £56,743 million.

Carrying value and fair value of reclassified assets
The table below sets out the carrying value and fair value of reclassified financial assets.

	31 December 2013		31 December 2012		31 December 2011		31 December 2010		31 December 2009		31 December 2008	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
From held for trading to loans and receivables	**–**	**–**	–	–	269	254	949	965	1,428	1,120	–	–
From held for trading to available-for-sale	**64**	**55**	867	1,104	1,980	1,890	6,116	6,431	10,478	10,176	13,542	13,542
From available-for-sale financial assets to loans and receivables	**379**	**324**	3,573	3,914	10,052	9,258	21,508	21,522	29,153	27,820	37,173	36,191
Total carrying value and fair value	**443**	**379**	4,440	5,018	12,301	11,402	28,573	28,918	41,059	39,116	50,715	49,733

During the year ended 31 December 2013, the carrying value of reclassified assets decreased by £3,997 million due to sales and maturities of £4,007 million less foreign exchange and other movements of £10 million.

No financial assets have been reclassified in accordance with the amendment to IAS 39 since 2009; the following disclosures relate to those assets which were reclassified in 2008 and 2009.

50 Financial instruments (continued)

a) Additional fair value gains (losses) that would have been recognised had the reclassifications not occurred
The table below shows the additional gains (losses) that would have been recognised since the date of reclassification in the Group's income statement or through the Group's available-for-sale revaluation reserve if the reclassifications had not occurred.

For assets reclassified in 2009

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
From held for trading to loans and receivables	**–**	7	11	14	13
From available-for-sale financial assets to loans and receivables	**–**	–	–	–	70
Total additional fair value gains	**–**	7	11	14	83

For assets reclassified in 2008

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
From held for trading to available-for-sale financial assets	**(46)**	285	26	136	904	981
From available-for-sale financial assets to loans and receivables	**(192)**	724	130	(134)	1,147	708
Total additional fair value (losses) gains	**(238)**	1,009	156	2	2,051	1,689

b) Actual amounts recognised in respect of reclassified assets
After reclassification the reclassified financial assets contributed the following amounts to the Group income statement:

For assets reclassified from held for trading to loans and receivables in 2009

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Net interest income	**–**	3	16	23	45
Impairment losses	**–**	(2)	(13)	–	(110)
(Losses) gains on disposal	**–**	(10)	32	109	17
Total amounts recognised	**–**	(9)	35	132	(48)

For assets reclassified from held for trading to available-for-sale financial assets in 2008

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Net interest income	**1**	13	141	184	281	442
Impairment losses	**–**	–	(8)	1	(305)	(215)
Gains (losses) on disposal	**105**	(91)	(26)	95	70	–
Total amounts recognised	**106**	(78)	107	280	46	227

For assets reclassified from available-for-sale financial assets to loans and receivables in 2009

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Net interest income	**–**	–	–	14	25
(Losses) gains on disposal	**–**	–	–	(9)	–
Total amounts recognised	**–**	–	–	5	25

For assets reclassified from available-for-sale financial assets to loans and receivables in 2008

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Net interest income	**5**	31	213	443	377	82
Impairment losses	**–**	(25)	(6)	(33)	(371)	(558)
Losses on disposal	**(343)**	(439)	(323)	(128)	(152)	16
Total amounts recognised	**(338)**	(433)	(116)	282	(146)	(460)

50 Financial instruments (continued)

(3) Fair values of financial assets and liabilities
The following table summarises the carrying values of financial assets and liabilities presented on the Group's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

	2013		2012[1]	
Group	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	**37,317**	**37,317**	63,671	63,671
Derivative financial instruments	**20,891**	**20,891**	35,855	35,855
Loans and receivables:				
Loans and advances to banks	**2,100**	**2,100**	4,874	4,875
Loans and advances to customers	**283,638**	**277,575**	303,622	294,222
Debt securities	**529**	**518**	3,813	3,997
Due from fellow Lloyds Banking Group undertakings	**193,874**	**193,874**	145,247	145,247
	480,141	**474,067**	457,556	448,341
Available-for-sale financial assets	**3,333**	**3,333**	6,052	6,052
Financial liabilities				
Deposits from banks	**3,175**	**3,204**	7,114	7,188
Customer deposits	**206,568**	**208,050**	205,269	206,860
Due to fellow Lloyds Banking Group undertakings	**220,738**	**220,738**	176,870	176,870
Trading liabilities	**36,624**	**36,624**	33,610	33,610
Derivative financial instruments	**19,137**	**19,137**	31,710	31,710
Debt securities in issue	**29,462**	**28,684**	49,521	50,028
Liabilities arising from non-participating investment contracts	**–**	**–**	27,166	27,166
Financial guarantees	**17**	**17**	14	14
Subordinated liabilities	**10,978**	**9,971**	12,491	10,585

[1]Restated – see note 1.

Company	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets				
Derivative financial instruments	**1,213**	**1,213**	1,565	1,565
Amounts due from subsidiaries	**33,790**	**33,790**	42,713	42,713
Financial liabilities				
Derivative financial instruments	**4**	**4**	10	10
Subordinated liabilities	**8,241**	**5,770**	9,021	8,375

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.

4) Fair value measurement
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market prices are not available, or are unreliable because of poor liquidity, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that are not financial instruments or for other assets and liabilities which are not carried at fair value in the Group's consolidated balance sheet. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships; premises and equipment; and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

Valuation control framework
The key elements of the control framework for the valuation of financial instruments include model validation, product implementation review and independent price verification. These functions are carried out by appropriately skilled risk and finance teams, independent of the business area responsible for the products.

50 Financial instruments (continued)

Model validation covers both qualitative and quantitative elements relating to new models. In respect of new products, a product implementation review is conducted pre- and post-trading. Pre-trade testing ensures that the new model is integrated into the Group's systems and that the profit and loss and risk reporting are consistent throughout the trade life cycle. Post-trade testing examines the explanatory power of the implemented model, actively monitoring model parameters and comparing in-house pricing to external sources. Independent price verification procedures cover financial instruments carried at fair value. The frequency of the review is matched to the availability of independent data, monthly being the minimum. Valuation differences in breach of established thresholds are escalated to senior management. The results from independent pricing and valuation reserves are reviewed monthly by senior management.

Formal committees, consisting of senior risk, finance and business management, meet at least quarterly to discuss and approve valuations in more judgemental areas, in particular for unquoted equities, structured credit, over-the-counter options and the Credit Valuation Adjustment (CVA) reserve.

Valuation of financial assets and liabilities
Assets and liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values.

Level 1
Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise equity shares, treasury bills and other government securities.

Level 2
Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data. Examples of such financial instruments include most over-the-counter derivatives, financial institution issued securities, certificates of deposit and certain asset-backed securities.

Level 3
Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include the Group's venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are also classified as level 3.

Unless otherwise noted, the following disclosures are provided separately for assets and liabilities carried at fair value and those carried at amortised cost.

The Group manages valuation adjustments for its derivative exposures on a net basis; the Group determines their fair values on the basis of their net exposures. In all other cases, fair values of financial assets and liabilities measured at fair value are determined on the basis of their gross exposures.

There were no transfers between level 1 and level 2 during the period.

50 Financial instruments (continued)

Financial assets and liabilities carried at fair value
Valuation hierarchy
The table below analyses the financial assets and liabilities of the Group which are carried at fair value. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable. The fair value measurement approach is recurring in nature.

Valuation hierarchy

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2013				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	32,448	–	32,448
Loans and advances to banks	–	2,556	–	2,556
Debt securities:				
Government securities	115	–	–	115
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	1,458	–	1,458
Asset-backed securities:				
Mortgage-backed securities	–	–	–	–
Other asset-backed securities	–	4	–	4
Corporate and other debt securities	–	518	–	518
	115	1,980	–	2,095
Equity shares	82	–	130	212
Treasury and other bills	6	–	–	6
Total trading and other financial assets at fair value through profit or loss	203	36,984	130	37,317
Available-for-sale financial assets				
Debt securities:				
Government securities	85	28	–	113
Bank and building society certificates of deposit	–	15	–	15
Asset-backed securities:				
Mortgage-backed securities	–	749	–	749
Other asset-backed securities	–	518	–	518
Corporate and other debt securities	21	1,504	–	1,525
	106	2,814	–	2,920
Equity shares	–	38	375	413
Total available-for-sale financial assets	106	2,852	375	3,333
Derivative financial instruments	–	20,451	440	20,891
Total financial assets carried at fair value	309	60,287	945	61,541
Trading and other financial liabilities through profit and loss				
Liabilities held at fair value through profit and loss	–	–	39	39
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	31,562	–	31,562
Short positions in securities	5,023	–	–	5,023
	5,023	31,562	–	36,585
Total trading and other financial liabilities at fair value through profit and loss	5,023	31,562	39	36,624
Derivative financial instruments	–	19,091	46	19,137
Financial guarantees	–	–	17	17
Total financial liabilities carried at fair value	5,023	50,653	102	55,778

There were no significant transfers between level 1 and level 2 during the year.

50 Financial instruments (continued)

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2012				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	28,372	–	28,372
Loans and advances to banks	–	729	–	729
Debt securities:				
Government securities	184	2,002	–	2,186
Other public sector securities	–	154	–	154
Bank and building society certificates of deposit	–	2,399	–	2,399
Asset-backed securities:				
Mortgage-backed securities	–	18	–	18
Other asset-backed securities	–	4	–	4
Corporate and other debt securities	–	4,408	14	4,422
	184	8,985	14	9,183
Equity shares	24,953	–	149	25,102
Treasury and other bills	285	–	–	285
Total trading and other financial assets at fair value through profit or loss	25,422	38,086	163	63,671
Available-for-sale financial assets				
Debt securities:				
Government securities	113	–	–	113
Bank and building society certificates of deposit	–	25	–	25
Asset-backed securities:				
Mortgage-backed securities	–	882	–	882
Other asset-backed securities	–	285	21	306
Corporate and other debt securities	22	4,234	–	4,256
	135	5,426	21	5,582
Equity shares	16	47	407	470
Total available-for-sale financial assets	151	5,473	428	6,052
Derivative financial instruments	–	35,683	172	35,855
Total financial assets carried at fair value	25,573	79,242	763	105,578
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	32,449	–	32,449
Short positions in securities	1,146	–	–	1,146
Other	15	–	–	15
Total trading liabilities	1,161	32,449	–	33,610
Derivative financial instruments	–	31,656	54	31,710
Financial guarantees	–	–	14	14
Total financial liabilities carried at fair value	1,161	64,105	68	65,334

50 Financial instruments (continued)

Valuation methodology

Loans and advances and debt securities

Loans and advances and debt securities measured at fair value and classified as level 2 are valued by discounting expected cash flows using an observable credit spread applicable to the particular instrument.

Where there is limited trading activity in debt securities, the Group uses valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes to determine an appropriate valuation. Debt securities are classified as level 3 if there is a significant valuation input that cannot be corroborated through market sources or where there are materially inconsistent values for an input. Asset classes classified as level 3 mainly comprise certain collateralised loan obligations and collateralised debt obligations.

Equity investments

Unlisted equity and fund investments are valued using different techniques in accordance with the Group's valuation policy and International Private Equity and Venture Capital Guidelines.

Depending on the business sector and the circumstances of the investment, unlisted equity valuations are based on earnings multiples, net asset values or discounted cash flows.

- A number of earnings multiples are used in valuing the portfolio including price earnings, earnings before interest and tax and earnings before interest, tax, depreciation and amortisation. The particular multiple selected being appropriate for the type of business being valued and is derived by reference to the current market-based multiple. Consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple.
- Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple.
- For fund investments the most recent capital account value calculated by the fund manager is used as the basis for the valuation and adjusted, if necessary, to align valuation techniques with the Group's valuation policy.

Unlisted equity investments and investments in property partnerships held in the life assurance funds are valued using third party valuations. Management take account of any pertinent information, such as recent transactions and information received on particular investments, to adjust the third party valuations where necessary.

Derivatives

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

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

Complex interest rate and foreign exchange products where there is significant dispersion of consensus pricing or where implied funding costs are material and unobservable are classified as level 3.

Where credit protection, usually in the form of credit default swaps, has been purchased or written on asset-backed securities, the security is referred to as a negative basis asset-backed security and the resulting derivative assets or liabilities have been classified as either level 2 or level 3 according to the classification of the underlying asset-backed security.

Liabilities held at fair value through profit or loss

These principally comprise debt securities in issue which are classified as level 2 and their fair value is determined using techniques whose inputs are based on observable market data.

50 Financial instruments (continued)

Movements in level 3 portfolio

The table below analyses movements in the level 3 financial assets portfolio (recurring measurement):

	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Derivative assets £m	Total financial assets £m
At 1 January 2012	432	1,825	351	2,608
Exchange and other adjustments	9	(60)	–	(51)
Gains (losses) recognised in the income statement within other income	5	(356)	(169)	(520)
Losses recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	–	(60)	–	(60)
Purchases	22	218	–	240
Sales	(305)	(1,138)	(10)	(1,453)
Transfers out of the level 3 portfolio	–	(1)	–	(1)
At 31 December 2012	163	428	172	763
Exchange and other adjustments	**4**	**5**	**6**	**15**
Gains recognised in the income statement within other income	**84**	**8**	**198**	**290**
Gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	**–**	**30**	**–**	**30**
Purchases	**11**	**44**	**1**	**56**
Sales	**(140)**	**(127)**	**(93)**	**(360)**
Transfers into the level 3 portfolio	**11**	**12**	**162**	**185**
Transfers out of the level 3 portfolio	**(3)**	**(25)**	**(6)**	**(34)**
At 31 December 2013	**130**	**375**	**440**	**945**
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December 2013	**13**	**(1)**	**178**	**190**
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December 2012	(16)	(33)	(169)	(218)

The table below analyses movements in the level 3 financial liabilities portfolio:

	Trading and other financial liabilities at fair value through profit and loss £m	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities £m
At 1 January 2012	–	31	17	48
Losses (gains) recognised in the income statement within other income	–	22	(3)	19
Transfers into the level 3 portfolio	–	16	–	16
Redemptions	–	(15)	–	(15)
At 31 December 2012	–	54	14	68
Exchange and other adjustments	**–**	**1**	**–**	**1**
Losses (gains) recognised in the income statement within other income	**10**	**(28)**	**3**	**(15)**
Additions	**29**	**–**	**–**	**29**
Redemptions	**–**	**38**	**–**	**38**
Transfers into the level 3 portfolio	**–**	**(19)**	**–**	**(19)**
At 31 December 2013	**39**	**46**	**17**	**102**
Losses (gains) recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December 2013	**(10)**	**49**	**(3)**	**36**
Losses (gains) recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December 2012	–	(22)	3	(19)

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.

50 Financial instruments (continued)

Level 3 portfolio

Sensitivity of level 3 valuations

	Valuation techniques	Significant unobservable inputs[1]	**At 31 December 2013** Carrying value £m	Effect of reasonably possible alternative assumptions[2] Favourable changes £m	Unfavourable changes £m	At 31 December 2012 Carrying value £m	Effect of reasonably possible alternative assumptions[2] Favourable changes £m	Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss								
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**130**	**17**	**(16)**	163	29	(8)
			130			163		
Available-for-sale financial assets								
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**375**	**28**	**(19)**	428	36	(11)
Derivative financial assets			**375**			428		
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (62bps/192bps)	**278**	**25**	**(15)**	172	27	(19)
	Option pricing model	Interest rate volatility (3%/112%)	**162**	**1**	**(2)**	–	–	–
			440			172		
Level 3 financial assets carried at fair value			**945**			763		
Trading and other financial liabilities at fair value through profit and loss			**39**	**1**	**(1)**	–	–	–
Derivative financial liabilities								
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (62bps/192bps)	**8**	**–**	**–**	54	–	–
	Option pricing model	Interest rate volatility (3%/112%)	**38**	**–**	**–**	–	–	–
			46			54		
Financial guarantees			**17**			14		
Level 3 financial liabilities carried at fair value			**102**			68		

[1]Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.

[2]Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

[3]Underlying asset/net asset values represented fair value.

Unobservable inputs
Significant unobservable inputs affecting the valuation of debt securities, unlisted equity investments and derivatives are as follows:

- Interest rates and inflation rates are referenced in some derivatives where the payoff that the holder of the derivative receives depends on the behaviour of those underlying references through time.
- Credit spreads represent the premium above the benchmark reference instrument required to compensate for lower credit quality; higher spreads lead to a lower fair value.
- Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes.
- Earnings multiples are used to value certain unlisted equity investments; a higher earnings multiple will result in a higher fair value.

Reasonably possible alternative assumptions
Valuation techniques applied to many of the Group's level 3 instruments often involve the use of two or more inputs whose relationship is interdependent. The calculation of the effect of reasonably possible alternative assumptions included in the table above reflects such relationships.

Debt securities
Reasonably possible alternative assumptions have been determined in respect of the Group's structured credit investment by flexing credit spreads.

50 Financial instruments (continued)

Derivatives
Reasonably possible alternative assumptions have been determined in respect of the Group's derivative portfolios as follows:

- Uncollateralised inflation swaps are valued using appropriate discount spreads for such transactions. These spreads are not generally observable for longer maturities. The reasonably possible alternative valuations reflect flexing of the spreads for the differing maturities to alternative values of between 62 bps and 192 bps (2012: 51 bps and 260 bps).
- Swaptions are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities have been flexed within a range of 3 per cent to 112 per cent (2012: 31 per cent and 79 per cent).

Unlisted equity, venture capital investments and investments in property partnerships
The valuation techniques used for unlisted equity and venture capital investments vary depending on the nature of the investment. Reasonably possible alternative valuations for these investments have been calculated by reference to the approach taken, as appropriate to the business sector and investment circumstances and as such the following inputs have been considered:

- for valuations derived from earnings multiples, consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple;
- the discount rates used in discounted cash flow valuations; and
- in line with International Private Equity and Venture Capital Guidelines, the values of underlying investments in fund investments portfolios.

Financial assets and liabilities carried at amortised cost

Valuation hierarchy
The table below analyses the fair values of the financial assets and liabilities of the Group which are carried at amortised cost. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2013				
Loans and receivables:				
Loans and advances to customers	–	–	277,575	277,575
Loans and advances to banks	–	–	2,100	2,100
Debt securities	7	42	469	518
Due from fellow Lloyds Banking Group undertakings	–	–	193,874	193,874
Deposits from banks	–	3,204	–	3,204
Customer deposits	–	189,317	18,733	208,050
Due to fellow Lloyds Banking Group undertakings	–	220,738	–	220,738
Debt securities in issue	–	28,509	175	28,684
Subordinated liabilities	–	9,971	–	9,971

Note: Comparatives not provided as disclosure not required in 2012.

Valuation methodology
Financial assets
The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value taking into account expected credit losses, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair value of wholesale loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk.

The fair values of debt securities, which were previously within assets held for trading and were reclassified to loans and receivables, are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

Financial liabilities
The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using discounted cash flow techniques at a rate which reflects market rates of interest and the Group's own credit spread.

50 Financial instruments (continued)

(5) Transfers of financial assets

A. Transferred financial assets that continue to be recognised in full

The Group enters into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets covered as substantially all of the risks and rewards, including credit, interest rate, prepayment and other price risks are retained by the Group. In all cases, the transferee has the right to sell or repledge the assets concerned.

As set out in note 19, included within loans and receivables are loans transferred under the Group's securitisation and covered bond programmes. As the Group retains all of a majority of the risks and rewards associated with these loans, including credit, interest rate, prepayment and liquidity risk, they remain on the Group's balance sheet. Assets transferred into the Group's securitisation and covered bond programmes are not available to be used by the Group whilst the assets are within the programmes. However, the Group retains the right to remove loans from the covered bond programmes where they are in excess of the programme's requirements. In addition, where the Group has retained some of the notes issued by securitisation and covered bond programmes, the Group has the ability to sell or pledge these retained notes.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For repurchase and securities lending transactions, the associated liabilities represent the Group's obligation to repurchase the transferred assets. For securitisation programmes, the associated liabilities represent the external notes in issue (note 34). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
At 31 December 2013		
Repurchase and securities lending transactions		
Trading and other financial assets at fair value through profit or loss	**2,073**	**149**
Available-for-sale financial assets	**1,132**	**691**
Loans and receivables:		
Loans and advances to customers	**46,818**	**3,212**
Debt securities classified as loans and receivables	**1,124**	**–**
Securitisation programmes		
Loans and receivables:		
Loans and advances to customers	**49,337**	**12,593**[1]

[1] Excludes securitisation notes held by the Group (£24,975 million).

	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
At 31 December 2012		
Repurchase and securities lending transactions		
Trading and other financial assets at fair value through profit or loss	703	189
Available-for-sale financial assets	2,439	464
Loans and receivables:		
Loans and advances to customers	44,451	5,300
Debt securities classified as loans and receivables	493	403
Securitisation programmes		
Loans and receivables:		
Loans and advances to customers[1]	67,016	17,624[2]

[1] Includes US residential mortage-backed securities and associated liabilities whose carrying values were £185 million and £221 million respectively; the associated liabilities have recourse only to the securities transferred and, at 31 December 2012, the fair values of the securities and the associated liabilities were £244 million and £311 million respectively, a difference of £67 million.

[2] Excludes securitisation notes held by the Group (£33,570 million).

B. Transferred financial assets derecognised in their entirety with ongoing exposure

No such assets remained at 31 December 2013. For 31 December 2012, the following information by type of ongoing exposure relates to assets and liabilities arising from contractual rights or obligations retained or obtained in connection with financial assets that have been derecognised in their entirety.

50 Financial instruments (continued)

	Carrying amount of ongoing exposure in balance sheet			
		At fair value through profit or loss		
	Loans and receivables £m	Designated upon initial recognition £m	Fair value of ongoing exposure £m	Maximum exposure to loss £m
At 31 December 2012				
Debt securities	199	–	237	199[1]
Liquidity facilities	56	–	55	56[1]
Fund investments	–	70	70	100[2]
Total	255	70	362	355

[1] Amount represents the carrying amount of the asset.

[2] Amount represents the carrying amount of the asset plus undrawn commitments of £30 million.

Debt securities shown in the table above were notes held in non-controlled securitisation vehicles representing the Group's ongoing involvement in financial assets transferred into those securitisation vehicles in prior years. The debt securities, which benefit from significant credit enhancement, were classified as available-for-sale financial assets and are managed on a similar basis to the Group's other non-traded asset backed securities.

Fund investments shown in the table above were equity and debt interests in an investment fund representing the Group's ongoing involvement in financial assets transferred into the fund in a prior year. The fund investments were designated at fair value through profit or loss and were managed on a similar basis to the Group's trading assets.

Liquidity facilities were to asset-backed conduits of Lloyds Bank plc which include assets previously recognised by the Group.

The Group had no obligation or option to repurchase any of the assets transferred.

(5) Financial instruments subject to offsetting, enforceable master netting agreements and similar arrangements
The following information relates to financial assets and liabilities which have been set off in the balance sheet and those which have not been set off but for which the Group has enforceable master netting agreements in place with counterparties.

At 31 December 2013	Gross amounts of assets/liabilities £m	Amounts set off in the balance sheet[3] £m	Net amounts presented in the balance sheet £m
Financial assets			
Trading and other financial assets at fair value through profit or loss[1]	**2,463**	**–**	**2,463**
Derivative financial instruments	**20,891**	**–**	**20,891**
Loans and receivables:			
Loans and advances to banks[1]	**2,100**	**–**	**2,100**
Loans and advances to customers[1]	**283,589**	**–**	**283,589**
Debt securities	**529**	**–**	**529**
Reverse repurchase agreements	**39,340**	**(4,437)**	**34,903**
Available-for-sale financial assets	**3,333**	**–**	**3,333**
Financial liabilities			
Deposits from banks[2]	**2,552**	**–**	**2,552**
Customer deposits[2]	**206,152**	**–**	**206,152**
Trading and after financial liabilities at fair value through profit or loss[2]	**5,062**	**–**	**5,062**
Repurchase agreements	**37,038**	**(4,437)**	**32,601**
Derivative financial instruments	**19,173**	**–**	**19,137**

50 Financial instruments (continued)

At 31 December 2013	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[4] Financial instruments £m	Cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets				
Trading and other financial assets at fair value through profit or loss[1]	**2,463**	**(6)**	**–**	**2,457**
Derivative financial instruments	**20,891**	**(6,552)**	**(1,162)**	**13,177**
Loans and receivables:				
Loans and advances to banks[1]	**2,100**	**–**	**–**	**2,100**
Loans and advances to customers[1]	**283,589**	**(2,571)**	**(49)**	**280,969**
Debt securities	**529**	**–**	**–**	**529**
Reverse repurchase agreements	**34,903**	**(4,160)**	**(416)**	**30,327**
Available-for-sale financial assets	**3,333**	**(13)**	**–**	**3,320**
Financial liabilities				
Deposits from banks[2]	**2,552**	**–**	**(1,153)**	**1,399**
Customer deposits[2]	**206,152**	**(1,851)**	**(425)**	**203,876**
Trading and after financial liabilities at fair value through profit or loss[2]	**5,062**	**–**	**–**	**5,062**
Repurchase agreements	**32,601**	**(4,899)**	**(49)**	**27,653**
Derivative financial instruments	**19,137**	**(6,552)**	**–**	**12,585**

At 31 December 2012	Gross amounts of assets/liabilities £m	Amounts set off in the balance sheet[3] £m	Net amounts presented in the balance sheet £m
Financial assets			
Trading and other financial assets at fair value through profit or loss[1]	34,678	–	34,678
Derivative financial instruments	35,855	–	35,855
Loans and receivables:			
Loans and advances to banks[1]	4,791	–	4,791
Loans and advances to customers[1]	283,636	–	283,636
Debt securities	3,813	–	3,813
Reverse repurchase agreements	34,372	(5,294)	29,078
Available-for-sale financial assets	6,052	–	6,052
Financial liabilities			
Deposits from banks[2]	4,501	–	4,501
Customer deposits[2]	205,077	–	205,077
Trading and after financial liabilities at fair value through profit or loss[2]	1,161	–	1,161
Repurchase agreements	40,547	(5,294)	35,253
Derivative financial instruments	31,710	–	31,710

50 Financial instruments (continued)

At 31 December 2012	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[4] Financial instruments £m	Cash collateral received/pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets				
Trading and other financial assets at fair value through profit or loss[1]	34,678	(123)	–	34,555
Derivative financial instruments	35,855	(20,733)	(2,638)	12,484
Loans and receivables:				
Loans and advances to banks[1]	4,791	–	(135)	4,656
Loans and advances to customers[1]	283,636	(2,055)	(2)	281,579
Debt securities	3,813	–	–	3,813
Reverse repurchase agreements	29,078	(8,863)	(196)	20,019
Available-or-sale financial assets	6,052	(1)	–	6,051
Financial liabilities				
Deposits from banks[2]	4,501	–	(2,638)	1,863
Customer deposits[2]	205,077	(1,362)	(196)	203,519
Trading and after financial liabilities at fair value through profit or loss[2]	1,161	–	–	1,161
Repurchase agreements	35,253	(9,680)	(2)	25,571
Derivative financial instruments	31,710	(20,733)	(135)	10,842

[1]Excluding reverse repurchase agreements.

[2]Excluding repurchase agreements.

[3]The amounts set off in the balance sheet as shown above represent derivatives and repurchase agreements with central clearing houses which meet the criteria for offsetting under IAS 32.

[4]The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

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

51 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: credit risk; market risk, which includes interest rate risk and currency risk; and liquidity risk. Qualitative and quantitative information about the Group's management of these risks is given below.

(1) Credit risk
The Group's credit risk exposure arises in respect of the instruments below and predominantly in the United Kingdom, the European Union, Australia and the United States. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems on inputs and measure the credit risk of loans and advances to customers and banks at a counterparty level using three components; (i) the probability of default by the counterparty on its contractual obligations; (ii) the current exposures to the counterparty and their likely future development, from which the Group derives the exposure at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The Group uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers, such as asset sales and credit derivative based transactions.

51 Financial risk management (continued)

A. Maximum credit exposure

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

	Group	
	2013 £m	2012[1] £m
Loans and receivables:		
Loans and advances to banks, net[2]	**2,100**	4,873
Loans and advances to customers, net[2]	**283,638**	303,622
Debt securities, net[2]	**529**	3,813
Due from fellow Lloyds Banking Group undertakings	**193,874**	145,247
Deposit amounts available for offset[3]	**(1,851)**	(1,362)
	478,290	456,193
Available-for-sale financial assets (excluding equity shares)	**2,919**	5,582
Trading and other financial assets at fair value through profit or loss (excluding equity shares)[4]:		
Loans and advances	**35,009**	29,101
Debt securities, treasury and other bills	**2,101**	9,468
	37,110	38,569
Derivative assets:		
Derivative assets, before offsetting under master netting arrangements	**20,891**	35,855
Amounts available for offset under master netting arrangements[3]	**(6,552)**	(20,733)
	14,339	15,122
Assets arising from reinsurance contracts held	**–**	42
Financial guarantees	**659**	5,330
Irrevocable loan commitments and other credit-related contingencies[5]	**13,829**	13,517
Maximum credit risk exposure	**547,146**	534,355
Maximum credit risk exposure before offset items	**555,549**	556,450

[1]Restated – see note 1.

[2]Amounts shown net of related impairment allowances.

[3]Deposit amounts available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[4]Includes assets within the Group's unit-linked funds for which credit risk is borne by the policyholders and assets within the Group's With-Profits funds for which credit risk is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back related contract liabilities.

[5]See note 49 – Contingent liabilities and commitments for further information.

51 Financial risk management (continued)

B. Credit quality of assets

Loans and receivables

The analysis of lending between retail and wholesale has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within wholesale are exposures to corporate customers and other large institutions.

Loans and advances

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2013						
Neither past due nor impaired	**2,095**	**225,104**	**9,170**	**26,396**	**260,670**	**9,846**
Past due but not impaired	**5**	**9,977**	**163**	**660**	**10,800**	**–**
Impaired – no provision required	**–**	**326**	**442**	**914**	**1,682**	**–**
– provision held	**–**	**5,589**	**291**	**17,480**	**23,360**	**–**
Gross	**2,100**	**240,996**	**10,066**	**45,450**	**296,512**	**9,846**
Allowance for impairment losses (note 22)	**–**	**(1,980)**	**(239)**	**(10,655)**	**(12,874)**	**–**
Net balance sheet carrying value	**2,100**				**283,638**	**9,846**
31 December 2012[1]						
Neither past due nor impaired	4,874	219,939	12,703	39,811	272,453	14,340
Past due but not impaired	–	10,554	391	1,147	12,092	–
Impaired – no provision required	–	409	635	965	2,009	–
– provision held	–	6,564	424	27,961	34,949	–
Gross	4,874	237,466	14,153	69,884	321,503	14,340
Allowance for impairment losses (note 22)	–	(2,542)	(371)	(14,968)	(17,881)	–
Net balance sheet carrying value	4,874				303,622	14,340

[1]Restated – see note 1.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(h). All impaired loans which exceed certain thresholds, principally within the Group's wholesale and corporate businesses, are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security. Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £18,433 million (2012: £28,970 million).

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51 Financial risk management (continued)

Loans and advances which are neither past due nor impaired

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2013						
Good quality	**2,074**	**221,484**	**6,202**	**9,455**		**9,839**
Satisfactory quality	**21**	**2,659**	**2,399**	**8,351**		**5**
Lower quality	**–**	**301**	**275**	**7,144**		**2**
Below standard, but not impaired	**–**	**660**	**294**	**1,446**		**–**
Total loans and advances which are neither past due nor impaired	**2,095**	**225,104**	**9,170**	**26,396**	**260,670**	**9,846**
31 December 2012						
Good quality	4,737	214,017	8,820	10,949		14,306
Satisfactory quality	24	4,227	3,248	11,972		25
Lower quality	–	542	282	12,473		6
Below standard, but not impaired	8	1,153	353	4,417		3
Total loans and advances which are neither past due nor impaired	4,769	219,939	12,703	39,811	272,453	14,340

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models.

Loans and advances which are past due but not impaired

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2013						
0-30 days	**5**	**4,556**	**142**	**261**	**4,959**	**–**
30-60 days	**–**	**2,165**	**20**	**61**	**2,246**	**–**
60-90 days	**–**	**1,447**	**1**	**47**	**1,495**	**–**
90-180 days	**–**	**1,809**	**–**	**40**	**1,849**	**–**
Over 180 days	**–**	**–**	**–**	**251**	**251**	**–**
Total loans and advances which are past due but not impaired	**5**	**9,977**	**163**	**660**	**10,800**	**–**
31 December 2012						
0-30 days	–	4,902	297	654	5,853	–
30-60 days	–	2,166	67	107	2,340	–
60-90 days	–	1,460	21	281	1,762	–
90-180 days	–	2,026	5	18	2,049	–
Over 180 days	–	–	1	87	88	–
Total loans and advances which are past due but not impaired	–	10,554	391	1,147	12,092	–

A financial asset is ‘past due’ if a counterparty has failed to make a payment when contractually due.

51 Financial risk management (continued)

Debt securities classified as loans and receivables
An analysis by credit rating of debt securities classified as loans and receivables is provided below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Asset-backed securities:							
Mortgage-backed securities	**1**	**–**	**–**	**157**	**–**	**–**	**158**
Other asset-backed securities	**120**	**–**	**–**	**79**	**22**	**7**	**228**
	121	**–**	**–**	**236**	**22**	**7**	**386**
Corporate and other debt securities	**–**	**25**	**–**	**–**	**–**	**249**	**274**
	121	**25**	**–**	**236**	**22**	**256**	**660**
Due from fellow Group undertakings: Mortgage-backed securities							**–**
Total debt securities classified as loans and receivables							**660**
At 31 December 2012							
Asset-backed securities:							
Mortgage-backed securities	600	943	646	704	312	909	4,114
Other asset-backed securities	120	–	167	–	128	1	416
	720	943	813	704	440	910	4,530
Corporate and other debt securities	–	–	–	–	–	271	271
	720	943	813	704	440	1,181	4,801
Due from fellow Group undertakings: Mortgage-backed securities							166
Total debt securities classified as loans and receivables							4,967

51 Financial risk management (continued)

Available-for-sale financial assets (excluding equity shares)

An analysis of available-for-sale financial assets is included in note 23. The credit quality of available-for-sale financial assets (excluding equity shares) is set out below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Debt securities:							
Government securities	**28**	**85**	**–**	**–**	**–**	**–**	**113**
Bank and building society certificates of deposit	**–**	**12**	**–**	**–**	**–**	**–**	**12**
Asset-backed securities:							
Mortgage-backed securities	**749**	**–**	**–**	**–**	**–**	**–**	**749**
Other asset-backed securities	**518**	**–**	**–**	**–**	**–**	**–**	**518**
	1,267	**–**	**–**	**–**	**–**	**–**	**1,267**
Corporate and other debt securities	**890**	**–**	**191**	**316**	**37**	**18**	**1,452**
	2,185	**97**	**191**	**316**	**37**	**18**	**2,844**
Due from fellow Group undertakings: Corporate and other debt securities							**75**
Total held as available-for-sale financial assets							**2,919**
At 31 December 2012							
Debt securities:							
Government securities	113	–	–	–	–	–	113
Bank and building society certificates of deposit	–	–	25	–	–	–	25
Asset-backed securities:							
Mortgage-backed securities	796	43	–	–	43	–	882
Other asset-backed securities	285	21	–	–	–	–	306
	1,081	64	–	–	43	–	1,188
Corporate and other debt securities	272	211	568	599	85	22	1,757
	1,466	275	593	599	128	22	3,083
Due from fellow Group undertakings: Corporate and other debt securities							2,499
Total held as available-for-sale financial assets							5,582

51 Financial risk management (continued)

Debt securities, treasury and other bills held at fair value through profit or loss:
An analysis of trading and other financial assets at fair value through profit or loss is included in note 15. The credit quality of debt securities, treasury and other bills held at fair value through profit or loss is set out below.

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2013							
Debt securities, treasury and other bills held at fair value through profit or loss							
Trading assets							
Government securities	**4**	**111**	**–**	**–**	**–**	**–**	**115**
Bank and building society certificates of deposit	**–**	**754**	**704**	**–**	**–**	**–**	**1,458**
Asset-backed securities	**–**	**–**	**–**	**–**	**4**	**–**	**4**
Corporate and other debt securities	**243**	**100**	**175**	**–**	**–**	**–**	**518**
Total debt securities held as trading assets	**247**	**965**	**879**	**–**	**4**	**–**	**2,095**
Treasury and other bills	**6**	**–**	**–**	**–**	**–**	**–**	**6**
Total held as trading assets	**253**	**965**	**879**	**–**	**4**	**–**	**2,101**
Total held at fair value through profit or loss	**253**	**965**	**879**	**–**	**4**	**–**	**2,101**
At 31 December 2012[1]							
Debt securities, treasury and other bills held at fair value through profit or loss							
Trading assets							
Government securities	184	–	–	–	–	–	184
Bank and building society certificates of deposit	–	1,636	603	–	–	–	2,239
Asset-backed securities	–	–	4	–	–	–	4
Corporate and other debt securities	320	90	–	–	–	–	410
Total debt securities held as trading assets	504	1,726	607	–	–	–	2,837
Treasury and other bills	285	–	–	–	–	–	285
Total held as trading assets	789	1,726	607	–	–	–	3,122
Other assets held at fair value through profit or loss							
Government securities	1,469	359	–	174	–	–	2,002
Other public sector securities	119	26	3	6	–	–	154
Bank and building society certificates of deposit	–	26	134	–	–	–	160
Asset-backed securities							
Mortgage-backed securities	–	–	18	–	–	–	18
Other asset-backed securities	–	–	–	–	–	–	–
	–	–	18	–	–	–	18
Corporate and other debt securities	192	673	764	490	1,593	64	3,776
Total other assets held at fair value through profit or loss	1,780	1,084	919	670	1,593	64	6,110
	2,569	2,810	1,526	670	1,593	64	9,232
Due from fellow Group undertakings:							
Corporate and other debt securities							236
Total held at fair value through profit or loss							9,468

[1]Restated – see note 1.

51 Financial risk management (continued)

Credit risk in respect of trading and other financial assets at past value through profit or loss held within the Group's unit-linked funds is borne by the policyholders and credit risk in respect of with-profits funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back those contract liabilities.

Derivative assets
An analysis of derivative assets is given in note 16. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £14,339 million (2012: £15,122 million), cash collateral of £1,162 million (2012: £2,638 million) was held and a further £236 million was due from OECD banks (2012: £439 million).

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
Derivative financial instruments							
At 31 December 2013							
Trading and other	**174**	**856**	**4,414**	**1,030**	**1,712**	**1**	**8,187**
Hedging	**–**	**661**	**2,133**	**35**	**2**	**5**	**2,836**
	174	**1,517**	**6,547**	**1,065**	**1,714**	**6**	**11,023**
Due from fellow Group undertakings							**9,868**
Total derivative financial instruments							**20,891**
At 31 December 2012							
Trading and other	152	6,505	7,805	1,683	3,848	95	20,088
Hedging	–	4,575	3,607	77	703	2	8,964
	152	11,080	11,412	1,760	4,551	97	29,052
Due from fellow Group undertakings							6,803
Total derivative financial instruments							35,855

Assets arising from reinsurance contracts held
No assets arising from reinsurance contracts were held at 31 December 2013 (2012: £42 million, all of which were due from insurers with a credit rating of AA or above).

Financial guarantees and irrevocable loan commitments
Financial guarantees represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

C. Collateral held as security for financial assets
The Group holds collateral against loans and receivables and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for trading and other financial assets at fair value through profit or loss and for derivative assets is also shown below.

Loans and receivables
The disclosures below are produced under the combined businesses approach used for the Group's segmental reporting. The Group believes that, for reporting periods immediately following a significant acquisition, such as the acquisition of HBOS in 2009, this combined businesses basis, which includes the allowance for loan losses at the acquisition on a gross basis, more fairly reflects the underlying provisioning status of the loans.

The Group holds collateral in respect of loans and advances to banks and customers as set out below. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

Loans and advances to banks
The Group may require collateral before entering into a credit commitment with another bank, depending on the type of financial product and the counterparty involved, and netting arrangements are obtained whenever possible and to the extent that such agreements are legally enforceable. Collateral is held as part of reverse repurchase or securities borrowing transactions.

There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £nil (2012: £83 million), against which the Group held collateral with a fair value of £nil (2012: £83 million), all of which the Group is able to repledge.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Loans and advances to customers
The Group holds collateral against loans and advances to customers in the form of mortgages over residential and commercial real estate, charges over business assets such as premises, inventory and accounts receivable, charges over financial instruments such as debt securities and equities, and guarantees received from third parties.

Retail lending
Mortgages
An analysis by loan-to-value ratio of the Group's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations.

51 Financial risk management (continued)

	Neither past due nor impaired £m	**Past due but not impaired £m**	**Impaired £m**	**Gross £m**
31 December 2013				
Less than 70 per cent	**105,228**	**3,224**	**1,431**	**109,883**
70 per cent to 80 per cent	**48,961**	**1,932**	**836**	**51,729**
80 per cent to 90 per cent	**35,155**	**1,843**	**939**	**37,937**
90 per cent to 100 per cent	**18,253**	**1,423**	**877**	**20,553**
Greater than 100 per cent	**17,507**	**1,555**	**1,832**	**20,894**
Total	**225,104**	**9,977**	**5,915**	**240,996**

	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
31 December 2012				
Less than 70 per cent	81,549	2,491	1,152	85,192
70 per cent to 80 per cent	44,178	1,620	713	46,511
80 per cent to 90 per cent	38,670	1,950	951	41,571
90 per cent to 100 per cent	26,631	1,737	969	29,337
Greater than 100 per cent	28,911	2,756	3,188	34,855
Total	219,939	10,554	6,973	237,466

Other

No collateral is held in respect of retail credit cards or overdrafts, or unsecured personal loans. For non-mortgage retail lending to small businesses, collateral will often include second charges over residential property and the assignment of life cover.

The majority of non-mortgage retail lending is unsecured. At 31 December 2013, impaired non-mortgage lending amounted to £494 million, net of an impairment allowance of £239 million (2012: £688 million net of an impairment allowance of £371 million). The fair value of the collateral held in respect of this lending was £nil (2012: £8 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation and the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Unimpaired non-mortgage retail lending amounted to £9,333 million (2012: £13,094 million). Lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination and are monitored throughout the credit lifecycle in accordance with business unit credit policy.

The Group credit risk disclosures for unimpaired non-mortgage retail lending report assets gross of collateral and therefore disclose the maximum loss exposure. The Group believes that this approach is appropriate 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. The value of collateral is re-evaluated and its legal soundness re-assessed if there is observable evidence of distress of the borrower. Unimpaired non-mortgage retail lending, including any associated collateral, is managed on a customer-by-customer basis rather than a portfolio basis. Key management personnel review collateral information on a case-by-case basis; no aggregated collateral information for the entire unimpaired non-mortgage retail lending portfolio is provided to key management personnel.

Wholesale lending

Reverse repurchase transactions

There were reverse repurchase agreements which are accounted for as collateralised loans with a carrying value of £nil (2012: £nil), against which the Group held collateral with a fair value of £nil (2012: £nil), all of which the Group is able to repledge. Included in these amounts are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £49 million (2012: £2 million). These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Impaired secured lending

The value of collateral is re-evaluated and its legal soundness re-assessed if there is observable evidence of distress of the borrower; this evaluation is used to determine potential loss allowances and management's strategy to try to either repair the business or recover the debt.

At 31 December 2013, impaired secured wholesale lending amounted to £7,414 million, net of an impairment allowance of £9,423 million (2012: £14,531 million, net of an impairment allowance of £13,291 million). The fair value of the collateral held in respect of impaired secured wholesale lending was £5,186 million (2012: £7,379 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured wholesale lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Impaired secured wholesale lending and associated collateral relates to lending to property companies and to customers in the financial, business and other services; transport, distribution and hotels; and construction industries.

51 Financial risk management (continued)

Unimpaired secured lending
Unimpaired secured wholesale lending amounted to £19,428 million (2012: £30,137 million). Wholesale lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination. The types of collateral taken and the frequency with which collateral is required at origination is dependent upon the size and structure of the borrower. For exposures to corporate customers and other large institutions, the Group will often require the collateral to include a first charge over land and buildings owned and occupied by the business, a mortgage debenture over the company's undertaking and one or more of its assets, and keyman insurance. The Group maintains policies setting out acceptable collateral, maximum loan-to-value ratios and other criteria to be considered when reviewing a loan application. The decision as to whether or not collateral is required will be based upon the nature of the transaction and the credit worthiness of the customer. Other than for project finance, object finance and income producing real estate where charges over the subject assets are a basic requirement, the provision of collateral will not determine the outcome of a credit application. The fundamental business proposition must evidence the ability of the business to generate funds from normal business sources to repay debt.

The extent to which collateral values are actively managed will depend on the credit quality and other circumstances of the obligor. Although lending decisions are predominantly based on expected cash flows, any collateral provided may impact the pricing and other terms of a loan or facility granted; this will have a financial impact on the amount of net interest income recognised and on internal loss-given-default estimates that contribute to the determination of asset quality.

For unimpaired secured wholesale lending, the Group reports assets gross of collateral and therefore discloses the maximum loss exposure. The Group believes that this approach is appropriate as collateral values at origination and during a period of good performance may not be representative of the value of collateral if the obligor enters a distressed state.

Unimpaired secured wholesale lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for impaired lending, this will not always involve assessing it on a fair value basis. No aggregated collateral information for the entire unimpaired secured wholesale lending portfolio is provided to key management personnel.

Trading and other financial assets at fair value through profit or loss (excluding equity shares)
In respect of trading and other financial assets at fair value through profit or loss, the fair value of collateral accepted under reverse repurchase transactions which are accounted for as collateralised loans that the Group is permitted by contract or custom to sell or repledge was £37,746 million (2012: £33,946 million). Of this, £20,595 million was sold or repledged (2012: £30,191 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £50,365 million (2012: £44,181 million). Of this amount, £49,688 million (2012: £43,246 million) had been resold or repledged as collateral for the Group's own transactions.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Derivative assets, after offsetting of amounts under master netting arrangements
The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £14,339 million (2012: £15,122 million), cash collateral of £1,162 million (2012: £2,638 million) was held.

Irrevocable loan commitments and other credit-related contingencies
At 31 December 2013, there were irrevocable loan commitments and other credit-related contingencies of £13,829 million (2012: £13,517 million). Collateral is held as security, in the event that lending is drawn down, on £2,193 million (2012: £3,502 million) of these balances.

Lending decisions in respect of irrevocable loan commitments are based on the obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. For wholesale unimpaired lending, it is the Group's practice to request sufficient collateral for secured irrevocable loan commitments. For retail mortgage commitments, the majority are for mortgages with a loan-to-value ratio of less than 100 per cent. Aggregated collateral information covering the entire balance of irrevocable loan commitments over which security will be taken is not provided to key management personnel.

D. Collateral pledged as security
Repo and stock lending transactions
The Group pledges assets primarily for repurchase agreements and securities lending transactions which are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge was £40,911 million (2012: £52,226 million). In addition, the following financial assets on the balance sheet have been pledged as collateral as part of securities lending transactions:

Assets pledged

	2013 £m	2012 £m
Trading and other financial assets at fair value through profit or loss	**1,925**	513
Loans and advances to customers	**43,424**	38,434
Debt securities classified as loans and receivables	**1,124**	63
Available-for-sale financial assets	**396**	1,903
	46,869	40,913

In addition to the assets defaulted above, the Group also holds assets that are encumbered through the Group's asset-backed conduits and its securitisation and covered bond programmes. Further details of these assets are provided in notes 19 and 20.

51 Financial risk management (continued)

E. Collateral repossessed

	2013 £m	2012 £m
Residential property	**773**	778
Other	**–**	1
	773	779

In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

(2) Market risk

Interest rate risk

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There are a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt.

At 31 December 2013 the aggregate notional principal of interest rate swaps designated as fair value hedges was £23,876 million (2012: £42,602 million) with a net fair value asset of £2,841 million (2012: £4,222 million) (see note 16). The losses on the hedging instruments were £1,419 million (2012: losses of £16 million). The gains on the hedged items attributable to the hedged risk were £1,380 million (2012: gains of £17 million).

In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next five years and the hedge accounting adjustments will be reported in the income statement as the cash flows arise. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2013 was £107,529 million (2012: £111,889 million) with a net fair value liability of £133 million (2012: asset of £1,000 million) (see note 16). In 2013, ineffectiveness recognised in the income statement that arises from cash flow hedges was a loss of £81 million (2012: gain of £6 million).

Currency risk

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the central market risk function.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using cross currency borrowings.

51 Financial risk management (continued)

The Group's main overseas operations are in the Americas, Australia and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

	Group	
	2013 £m	2012 £m
Functional currency of Group operations		
Euro:		
Gross exposure	**31**	14
Net investment hedge	**(464)**	(836)
	(433)	(822)
Australian Dollar:		
Gross exposure	**13**	1,133
Net investment hedge	**(13)**	(1,074)
	–	59
US Dollar:		
Gross exposure	**59**	77
Net investment hedge	**(62)**	(78)
	(3)	(1)
Other non-sterling	**1**	1
Total structural foreign currency exposures, after net investment hedges	**(435)**	(763)

(3) Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the FSA. 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, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category. Certain balances, included in the table below on the basis of their residual maturity, are repayable on demand upon payment of a penalty.

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 2013						
Deposits from banks	**2,178**	**24**	**133**	**850**	**88**	**3,273**
Customer deposits	**110,256**	**6,195**	**26,669**	**31,637**	**33,873**	**208,630**
Trading liabilities	**22,010**	**9,889**	**4,433**	**252**	**40**	**36,624**
Debt securities in issue	**3,919**	**630**	**5,339**	**12,766**	**8,402**	**31,056**
Liabilities arising from non-participating investment contracts	**–**	**–**	**–**	**–**	**–**	**–**
Subordinated liabilities	**280**	**145**	**1,318**	**5,220**	**5,647**	**12,610**
Total non-derivative financial liabilities	**138,643**	**16,883**	**37,892**	**50,725**	**48,050**	**292,193**
Derivative financial liabilities:	**–**	**–**	**–**	**–**	**–**	**–**
Gross settled derivative – outflow	**1,684**	**593**	**7,432**	**15,387**	**9,917**	**35,013**
Gross settled derivative – inflow	**(1,341)**	**(346)**	**(7,366)**	**(15,191)**	**(9,806)**	**(34,050)**
Gross settled derivative – netflow	**343**	**247**	**66**	**196**	**111**	**963**
Net settled derivative liabilities	**6,597**	**86**	**288**	**686**	**219**	**7,876**
Total derivative financial liabilities	**6,940**	**333**	**354**	**882**	**330**	**8,839**

51 Financial risk management (continued)

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 2012						
Deposits from banks	98,379	5,871	3,636	35,959	29,646	173,491
Customer deposits	145,878	7,085	22,197	43,429	6,520	225,109
Trading liabilities	12,132	5,100	9,855	3,303	3,280	33,670
Debt securities in issue	4,956	647	7,522	32,411	8,685	54,221
Liabilities arising from non-participating investment contracts	–	–	–	–	27,166	27,166
Subordinated liabilities	14	317	102	4,830	9,226	14,489
Total non-derivative financial liabilities	261,359	19,020	43,312	119,932	84,523	528,146
Derivative financial liabilities:						
Gross settled derivative – outflow	5,622	1,324	3,271	21,335	18,703	50,255
Gross settled derivative – inflow	(5,428)	(1,119)	(3,106)	(20,292)	(17,484)	(47,429)
Gross settled derivative – netflow	194	205	165	1,043	1,219	2,826
Net settled derivative liabilities	25,750	193	1,017	2,861	686	30,507
Total derivative financial liabilities	25,944	398	1,182	3,904	1,905	33,333

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 2013						
Amounts owed to fellow Group undertakings	**–**	**–**	**–**	**–**	**22,694**	**22,694**
Subordinated liabilities	**–**	**582**	**1,275**	**4,712**	**1,424**	**7,993**
Total non-derivative financial liabilities	**–**	**582**	**1,275**	**4,712**	**24,118**	**30,687**
At 31 December 2012						
Amounts owed to fellow Group undertakings	1,619	–	–	–	28,024	29,643
Subordinated liabilities	–	–	–	3,542	5,479	9,021
Total non-derivative financial liabilities	1,619	–	–	3,542	33,503	38,664

The Group's financial guarantee contracts are accounted for as financial instruments and measured at fair value on the balance sheet. The majority of the Group's financial guarantee contracts are callable on demand, were the guaranteed party to fail to meet its obligations. It is, however, expected that most guarantees will expire unused. The contractual nominal amounts of these guarantees totalled £659 million at 31 December 2013 (2012: £5,330 million) with £269 million expiring within one year; £nil between one and three years; £206 million between three and five years; and £184 million over five years (2012: £2,019 million expiring within one year; £784 million between one and three years; £560 million between three and five years; and £1,967 million over five years).

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £17 million (2012: £16 million) for the Group and £10 million (2012: £nil) for the Company per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond five years.

The majority of the Group's non-participating investment contract liabilities are unit-lined. These unit-lined products are invested in accordance with unit fund mandates. Classes are included in policyholder contracts to permit the deferral of sales, where necessary, so that linked assets can be released without being a forced seller.

Liabilities arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	**1-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
As at 31 December 2013	**–**	**–**	**–**	**–**	**–**	**–**
As at 31 December 2012	–	–	–	–	423	423

For insurance and participating investment contracts which are neither unit-linked nor in the Group's with-profit funds, in particular annuity liabilites, the aim is to invest in assets such that the cash flows on investments match those on the projected future liabilities.

51 Financial risk management (continued)

The following tables set out the amounts and residual maturities of the Group's off balance sheet contingent liabilities and commitments.

Group	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2013					
Acceptances and endorsements	**2**	**–**	**–**	**–**	**2**
Other contingent liabilities	**242**	**15**	**28**	**5**	**290**
Total contingent liabilities	**244**	**15**	**28**	**5**	**292**
Lending commitments	**27,806**	**1,080**	**1,509**	**1,537**	**31,932**
Other commitments	**4**	**–**	**–**	**–**	**4**
Total commitments	**27,810**	**1,080**	**1,509**	**1,537**	**31,936**
Total contingents and commitments	**28,054**	**1,095**	**1,537**	**1,542**	**32,228**

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2012					
Acceptances and endorsements	2	–	–	–	2
Other contingent liabilities	380	140	57	16	593
Total contingent liabilities	382	140	57	16	595
Lending commitments	27,959	2,987	2,052	1,840	34,838
Other commitments	4	–	–	–	4
Total commitments	27,963	2,987	2,052	1,840	34,842
Total contingents and commitments	28,345	3,127	2,109	1,856	35,437

(4) Insurance risk

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

The Group's appetite for solvency and earnings in insurance entities is reviewed and approved annually by the Board. Insurance risks are measured using a variety of techniques including stress and scenario testing, and, where appropriate, stochastic modelling. Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations, as well as evaluating the effectiveness of controls put in place to manage insurance risk.

52 Capital

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the Lloyds Banking Group Asset and Liability Committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight.

The Group's regulatory capital is divided into tiers depending on level of subordination and ability to absorb losses. Core tier 1 capital as defined in the FSA letter to the British Bankers' Association in May 2009, comprises mainly shareholders' equity and non-controlling interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected loss over accounting provisions and certain securitisation positions. Accounting equity is adjusted in accordance with PRA requirements, particularly in respect of pensions and available-for-sale assets. Tier 1 capital, as defined by the European Community Banking Consolidation Directive as implemented in the UK by the PRA's General Prudential Sourcebook (GENPRU), is core tier 1 capital plus tier 1 capital securities less 50 per cent of material holdings in financial companies. Tier 2 capital, defined by GENPRU, comprises qualifying subordinated debt and some additional provisions and reserves after deducting 50 per cent of the excess of expected loss over accounting provisions, and certain securitisation positions and material holdings in financial companies. In 2013 the transitional provision which allowed the deduction of unconsolidated investments as supervisory deductions from total capital expired, resulting in these investments now being deducted from tier 1 (50 per cent of the total) and tier 2 capital (also 50 per cent). Total capital is the sum of tier 1 and tier 2 capital after deducting supervisory deductions which include connected lending of a capital nature.

The Group's capital resources are summarised as follows:

	2013 £m	2012 £m
Tier 1 capital	**23,370**	24,345
Tier 2 capital	**6,185**	6,648
	29,555	30,993
Supervisory deductions	**(2,640)**	(423)
Total capital	**26,915**	30,570

The minimum total capital required under Pillar 1 of the Basel II framework is the Capital Resources Requirement (CRR) calculated as 8 per cent of risk weighted assets. In addition to the minimum requirements for total capital, the PRA has made statements to explain it also operates a framework of targets and expected buffers for core tier 1 and tier 1 capital.

In order to address the requirements of Pillar 2 of the Basel II framework, the PRA currently sets additional minimum requirements through the issuance of Individual Capital Guidance (ICG) for each UK bank calibrated by reference to the CRR. A key input into the PRA's ICG setting process is each bank's Internal Capital Adequacy Assessment Process. The Group has been given an ICG by the PRA. The PRA has made it clear, however, that ICG remains a confidential matter between each bank and the PRA.

The Group maintains its own buffer to ensure that the regulatory minimum requirements and regulatory targets and buffers are met at all times.

The Basel III reforms for an enhanced global capital accord were introduced in the EU through the implementation of the new Capital Requirements Directive and Regulation (CRDIV), published via the Official Journal of the European Union in June 2013. These rules, as implemented in the UK via Prudential Regulatory Authority (PRA) policy statement PS7/13, apply to reporting from 1 January 2014 and as such all future reporting will be in accordance with these rules, subject to transitional phasing permitted by PS7/13.

A number of final draft CRD IV implementing and regulatory technical standards have been issued by the European Banking Authority (EBA) with a number of other draft standards currently being taken through respective consultation processes. The Group continues to monitor their development very closely and to analyse their potential impact whilst ensuring that the Group continues to have a strong loss absorption capacity exceeding regulatory requirements as currently formulated.

During the year, the individual entities within the Group and the Group complied with all of the externally imposed capital requirements to which they are subject.

53 Cash flow statements

a Change in operating assets

	Group	
	2013 £m	2012 £m
Change in loans and receivables	**21,974**	54,204
Change in amounts due from Group undertakings	**(48,627)**	(47,749)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**6,044**	(16,310)
Change in other operating assets	**(285)**	(1,964)
Change in operating assets	**(20,894)**	(11,819)

b Change in operating liabilities

	Group	
	2013 £m	2012 £m
Change in deposits from banks	**(3,939)**	1,574
Change in customer deposits	**5,986**	4,683
Change in amounts due to Group undertakings	**43,868**	15,908
Change in debt securities in issue	**(19,601)**	(25,848)
Change in derivative financial instruments and trading liabilities	**(9,429)**	11,163
Change in investment contract liabilities	**2,787**	6,404
Change in other operating liabilities	**1,899**	811
Change in operating liabilities	**21,571**	14,695

Notes to the accounts

53 Cash flow statements (continued)

c Non-cash and other items

	Group 2013 £m	Group 2012 £m
Depreciation and amortisation	**228**	257
Revaluation of investment properties	**95**	116
Allowance for loan losses	**2,400**	4,269
Write-off of allowance for loan losses	**(8,298)**	(9,224)
Impairment of available-for-sale financial assets	**45**	397
Impairment of goodwill	**51**	–
Change in insurance contract liabilities	**28**	38
Payment protection insurance provision	**740**	850
Other provision movements	**121**	152
Net charge (credit) in respect of defined benefit schemes	**135**	(149)
Impact of consolidation and deconsolidation of OEICs[1]	**–**	(433)
Unwind of discount on impairment allowances	**(228)**	(329)
Foreign exchange element on balance sheet[2]	**575**	589
Interest expense on subordinated liabilities	**587**	657
Loss (profit) on disposal of businesses	**(533)**	7
Other non-cash items	**(919)**	(694)
Total non-cash items	**(4,973)**	(3,497)
Contributions to defined benefit schemes	**(185)**	(333)
Payments in respect of other provision	**(61)**	–
Payments in respect of payment protection insurance provision	**(507)**	(879)
Other	**(25)**	13
Total other items	**(728)**	(1,199)
Non-cash and other items	**(5,701)**	(4,696)

[1]These OEICs (Open-ended investment companies) are mutual funds which are consolidated if the Group manages the funds and also has a majority beneficial interest. The population of OEICs to be consolidated varies at each reporting date as external investors acquire and divest holdings in the various funds. The consolidation of these funds is effected by the inclusion of the fund investments and a matching liability to the unit holders, and changes in funds consolidated represent a non-cash movement on the balance sheet.

[2]When considering the movement on each line of the balance sheet, the impact of foreign exchange rate movements is removed in order to show the underlying cash impact.

53 Cash flow statements (continued)

d Analysis of cash and cash equivalents as shown in the balance sheet

	Group	
	2013 £m	2012 £m
Cash and balances with central banks	**7,369**	6,112
Less: mandatory reserve deposits[1]	**(407)**	(259)
	6,962	5,853
Loans and advances to banks	**2,100**	4,874
Less: amounts with a maturity of three months or more	**(1,115)**	(1,370)
	985	3,504
Total cash and cash equivalents	**7,947**	9,357

[1]Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

e Disposal and closure of group undertakings, joint ventures and associates

	2013 £m	2012 £m
Trading and other fair value financial assets through profit or loss	**35,165**	–
Loans and advances to customers	**5,722**	15
Loans and advances to banks	**1,614**	16
Investment property	**582**	–
Interest in joint ventures and associates	**591**	–
Goodwill	**468**	–
Value of in-force business	**128**	–
	44,270	31
Customer deposits	**(4,687)**	–
Debt securities in issue	**(299)**	–
Liabilities arising from insurance contracts and participating investment contracts	**(30,404)**	–
Non-controlling interests	**(357)**	(38)
Other net assets (liabilities)	**(6,392)**	51
	(42,139)	13
Net assets	**2,131**	44
Cash and cash equivalents disposed	**(1,614)**	–
Profit (loss) on sale	**533**	(7)
Net cash inflow (outflow)	**1,050**	37

Notes to the accounts

54 Restatement of prior period information

As explained in note 1, the Group has adopted IFRS 10 *Consolidated Financial Statements* and Amendments to IAS 19 *Employee Benefits* (IAS 19R) on 1 January 2013.

The Group has restated information for the preceding comparative periods.

The following tables summarise the adjustments arising on the adoption of IAS 19R and IFRS 10 to the Group's:

– income statement, statement of comprehensive income and statement of cash flows for the year ended 31 December 2012; and
– balance sheets at 31 December 2012 and 1 January 2012.
and the Company's:
– statement of comprehensive income and statement of cash flows for the year ended 31 December 2012; and
– balance sheets as at 31 December 2012 and 1 January 2012.

Consolidated income statement – year ended 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Interest and similar income	15,384	–	–	15,384
Interest and similar expense	(8,474)	(204)	–	(8,678)
Net interest income	6,910	(204)	–	6,706
Fee and commission income	1,659	–	–	1,659
Fee and commission expense	(536)	–	–	(536)
Net fee and commission income	1,123	–	–	1,123
Net trading income	3,492	204	–	3,696
Insurance premium income	36	–	–	36
Other operating income	277	–	–	277
Other income	4,928	204	–	5,132
Total income	11,838	–	–	11,838
Insurance claims	(2,985)	–	–	(2,985)
Total income, net of insurance claims	8,853	–	–	8,853
Regulatory provisions	(1,039)	–	–	(1,039)
Other operating expenses	(3,249)	–	(1)	(3,250)
Total operating expenses	(4,288)	–	(1)	(4,289)
Trading surplus	4,565	–	(1)	4,564
Impairment	(4,310)	–	–	(4,310)
Profit (loss) before tax	255	–	(1)	254
Taxation	(86)	–	11	(75)
Profit for the year	169	–	10	179
Profit attributable to non-controlling interests	41	–	–	41
Profit attributable to equity shareholders	128	–	10	138
Profit for the year	169	–	10	179

54 Restatement of prior period information (continued)

Consolidated statement of comprehensive income – year ended 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Profit for the year	169	–	10	179
Other comprehensive income				
Items that will not subsequently be reclassified to profit or loss:				
Post-retirement defined benefit scheme remeasurements:				
Remeasurements before taxation	–	–	(738)	(738)
Taxation	–	–	170	170
	–	–	(568)	(568)
Items that may subsequently be reclassified to profit or loss:				
Movements in revaluation reserve in respect of available-for-sale financial assets:				
Change in fair value	484	–	–	484
Income statement transfers in respect of disposals	(385)	–	–	(385)
Income statement transfers in respect of impairment	397	–	–	397
Taxation	(123)	–	–	(123)
	373	–	–	373
Movements in cash flow hedging reserve:				
Effective portion of changes in fair value	730	–	–	730
Net income statement transfers	(269)	–	–	(269)
Taxation	(83)	–	–	(83)
	378	–	–	378
Currency translation differences (tax: nil)	47	–	–	47
Other comprehensive income for the year, net of tax	798	–	(568)	230
Total comprehensive income for the year	967	–	(558)	409
Total comprehensive income attributable to non-controlling interests	41	–	–	41
Total comprehensive income attributable to equity shareholders	926	–	(558)	368
Total comprehensive income for the year	967	–	(558)	409

54 Restatement of prior period information (continued)

Consolidated cash flow statement – year ended 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Profit (loss) before tax	255	–	(1)	254
Adjustments for:				
Change in operating assets	(11,350)	(469)	–	(11,819)
Change in operating liabilities	14,226	469	–	14,695
Non-cash and other items	(4,697)	–	1	(4,696)
Tax paid	33	–	–	33
Net cash provided by operating activities	(1,533)	–	–	(1,533)
Cash flows from investing activities				
Purchase of available-for-sale financial assets	(2,083)	–	–	(2,083)
Proceeds from sale and maturity of available-for-sale financial assets	6,759	–	–	6,759
Purchase of fixed assets	(476)	–	–	(476)
Proceeds from sale of fixed assets	1,372	–	–	1,372
Acquisition of businesses, net of cash acquired	(11)	–	–	(11)
Disposal of businesses, net of cash disposed	37	–	–	37
Net cash provided by investing activities	5,598	–	–	5,598
Cash flows from financing activities				
Dividends paid to non-controlling interests	(22)	–	–	(22)
Interest paid on subordinated liabilities	(697)	–	–	(697)
Repayment of subordinated liabilities	(649)	–	–	(649)
Change in non-controlling interests	20	–	–	20
Net cash used in financing activities	(1,348)	–	–	(1,348)
Effects of exchange rate changes on cash and cash equivalents	(2)	–	–	(2)
Change in cash and cash equivalents	2,715	–	–	2,715
Cash and cash equivalents at beginning of year	6,642	–	–	6,642
Cash and cash equivalents at end of year	9,357	–	–	9,357

54 Restatement of prior period information (continued)

Consolidated balance sheet at 31 December 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Assets				
Cash and balances at central banks	6,112	–	–	6,112
Items in course of collection from banks	416	–	–	416
Trading and other financial assets at fair value through profit or loss	62,358	1,313	–	63,671
Derivative financial instruments	35,855	–	–	35,855
Loans and receivables:				
Loans and advances to banks	4,769	105	–	4,874
Loans and advances to customers	303,622	–	–	303,622
Debt securities	3,813	–	–	3,813
Due from fellow Lloyds Banking Group undertakings	145,247	–	–	145,247
	457,451	105	–	457,556
Available-for-sale financial assets	6,052	–	–	6,052
Investment properties	1,279	–	–	1,279
Goodwill	859	–	–	859
Value of in-force business	135	–	–	135
Other intangible assets	103	–	–	103
Tangible fixed assets	1,705	–	–	1,705
Current tax recoverable	576	–	–	576
Deferred tax assets	3,445	–	50	3,495
Retirement benefit assets	865	–	(132)	733
Other assets	4,896	36	–	4,932
Total assets	582,107	1,454	(82)	583,479

54 Restatement of prior period information (continued)

Consolidated balance sheet at 31 December 2012 (continued)

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Equity and liabilities				
Liabilities				
Deposits from banks	7,114	–	–	7,114
Customer deposits	205,269	–	–	205,269
Due to fellow Lloyds Banking Group undertakings	176,870	–	–	176,870
Items in course of transmission to banks	518	–	–	518
Trading and other financial liabilities at fair value through profit or loss	33,610	–	–	33,610
Derivative financial instruments	31,710	–	–	31,710
Notes in circulation	1,198	–	–	1,198
Debt securities in issue	49,521	–	–	49,521
Liabilities arising from insurance contracts and participating investment contracts	423	–	–	423
Liabilities arising from non-participating investment contracts	27,166	–	–	27,166
Other liabilities	9,726	1,454	–	11,180
Retirement benefit obligations	110	–	85	195
Current tax liabilities	58	–	–	58
Deferred tax liabilities	69	–	–	69
Other provisions	1,157	–	–	1,157
Subordinated liabilities	12,491	–	–	12,491
Total liabilities	557,010	1,454	85	558,549
Equity				
Share capital	3,763	–	–	3,763
Share premium account	18,655	–	–	18,655
Other reserves	11,321	–	–	11,321
Retained profits	(9,042)	–	(167)	(9,209)
Shareholders' equity	24,697	–	(167)	24,530
Non-controlling interests	400	–	–	400
Total equity	25,097	–	(167)	24,930
Total equity and liabilities	582,107	1,454	(82)	583,479

54 Restatement of prior period information (continued)

Consolidated balance sheet at 1 January 2012

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Assets				
Cash and balances at central banks	3,075	–	–	3,075
Items in course of collection from banks	379	–	–	379
Trading and other financial assets at fair value through profit or loss	45,347	908	–	46,255
Derivative financial instruments	36,253	–	–	36,253
Loans and receivables:				
Loans and advances to banks	5,410	48	–	5,458
Loans and advances to customers	345,412	–	–	345,412
Debt securities	11,276	–	–	11,276
Due from fellow Lloyds Banking Group undertakings	97,498	–	–	97,498
	459,596	48	–	459,644
Available-for-sale financial assets	10,498	–	–	10,498
Investment properties	1,686	–	–	1,686
Goodwill	859	–	–	859
Value of in-force business	147	–	–	147
Other intangible assets	76	–	–	76
Tangible fixed assets	2,372	–	–	2,372
Current tax recoverable	338	–	–	338
Deferred tax assets	3,977	–	(131)	3,846
Retirement benefit assets	394	–	579	973
Other assets	3,002	29	–	3,031
Total assets	567,999	985	448	569,432

54 Restatement of prior period information (continued)

Consolidated balance sheet at 1 January 2012 (continued)

	As previously reported £m	IFRS 10 £m	IAS 19 Revised £m	Restated £m
Equity and liabilities				
Liabilities				
Deposits from banks	5,540	–	–	5,540
Customer deposits	200,588	–	–	200,588
Due to fellow Lloyds Banking Group undertakings	160,962	–	–	160,962
Items in course of transmission to banks	332	–	–	332
Trading and other financial liabilities at fair value through profit or loss	20,805	–	–	20,805
Derivative financial instruments	33,385	–	–	33,385
Notes in circulation	1,145	–	–	1,145
Debt securities in issue	75,457	–	–	75,457
Liabilities arising from insurance contracts and participating investment contracts	385	–	–	385
Liabilities arising from non-participating investment contracts	22,207	–	–	22,207
Other liabilities	8,184	985	–	9,169
Retirement benefit obligations	107	–	57	164
Current tax liabilities	54	–	–	54
Deferred tax liabilities	1	–	–	1
Other provisions	1,064	–	–	1,064
Subordinated liabilities	13,613	–	–	13,613
Total liabilities	543,829	985	57	544,871
Equity				
Share capital	3,763	–	–	3,763
Share premium account	18,655	–	–	18,655
Other reserves	10,523	–	–	10,523
Retained profits	(9,170)	–	391	(8,779)
Shareholders' equity	23,771	–	391	24,162
Non-controlling interests	399	–	–	399
Total equity	24,170	–	391	24,561
Total equity and liabilities	567,999	985	448	569,432

54 Restatement of prior period information (continued)

Company statement of comprehensive income – year ended 31 December 2012

	As previously reported £m	IAS 19 Revised £m	Restated £m
Profit for the year	1,234	8	1,242
Other comprehensive income			
Items that will not subsequently be reclassified to profit or loss:			
Post-retirement defined benefit scheme remeasurements			
Remeasurement before taxation	–	(707)	(707)
Taxation	–	163	163
	–	(544)	(544)
Items that may subsequently be reclassified to profit or loss:			
Movements in cash flow hedging reserve:			
Effective portion of changes in fair value	–	–	–
Net income statement transfers	–	–	–
Taxation	–	–	–
	–	–	–
Other comprehensive income for the year, net of tax	–	(544)	(544)
Total comprehensive income for the year	1,234	(536)	698

Company cash flow statement

	As previously reported £m	IAS 19 Revised £m	Restated £m
Profit before tax	1,385	(5)	1,380
Adjustments for:			
Dividend income	(202)	–	(202)
Change in operating assets	1,257	–	1,257
Change in operating liabilities	(5,579)	–	(5,579)
Non-cash and other items	157	5	162
Tax paid	(1)	–	(1)
Net cash used in operating activities	(2,983)	–	(2,983)
Cash flows from investing activities	–	–	–
Cash flows from financing activities			
Dividends received from subsidiaries	202	–	202
Interest paid on subordinated liabilities	(455)	–	(455)
Net cash (used in) provided by financing activities	(253)	–	(253)
Change in cash and cash equivalents	(3,236)	–	(3,236)
Cash and cash equivalents at beginning of year	25,563	–	25,563
Cash and cash equivalents at end of year	22,327	–	22,327

[1]Restated – see note 1.

54 Restatement of prior period information (continued)

Company balance sheet at 31 December 2012

	Note	As previously reported £m	IAS 19 Revised £m	Restated £m
Assets				
Amounts owed by Group entities		42,713	–	42,713
Derivative financial instruments		1,565	–	1,565
Retirement benefit assets		839	(106)	733
Other assets		17	–	17
Investments in subsidiary undertakings		23,000	–	23,000
Total assets		68,134	(106)	68,028
Liabilities				
Amounts owed to Group entities		29,643	–	29,643
Derivative financial instruments		10	–	10
Other liabilities		469	–	469
Current tax liabilities		307	–	307
Retirement benefit obligations		110	31	141
Deferred tax liabilities		207	(32)	175
Subordinated liabilities		9,021	–	9,021
Total liabilities		39,767	(1)	39,766
Equity				
Issued share capital		3,763	–	3,763
Share premium account		18,655	–	18,655
Other reserves		9,693	–	9,693
Retained profits		(3,744)	(105)	(3,849)
Shareholders' equity		28,367	(105)	28,262
Total equity and liabilities		68,134	(106)	68,028

Notes to the accounts

54 Restatement of prior period information (continued)

Company balance sheet at 1 January 2012

	Note	As previously reported £m	IAS 19 Revised £m	Restated £m
Assets				
Amounts owed by Group entities		47,378	–	47,378
Derivative financial instruments		1,857	–	1,857
Retirement benefit assets		375	598	973
Other assets		17	–	17
Investments in subsidiary undertakings		23,000	–	23,000
Total assets		72,627	598	73,225
Liabilities				
Amounts owed to Group entities		35,237	–	35,237
Derivative financial instruments		10	–	10
Other liabilities		457	–	457
Current tax liabilities		283	–	283
Retirement benefit obligations		107	23	130
Deferred tax liabilities		82	144	226
Subordinated liabilities		9,318	–	9,318
Total liabilities		45,494	167	45,661
Equity				
Issued share capital		3,763	–	3,763
Share premium account		18,655	–	18,655
Other reserves		9,693	–	9,693
Retained profits		(4,978)	431	(4,547)
Shareholders' equity		27,133	431	27,564
Total equity and liabilities		72,627	598	73,225

55 Future accounting developments

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2013 and have not been applied in preparing these financial statements. Save as disclosed the full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
Amendment to IAS 32 *Financial Instruments: Presentation – 'Offsetting Financial Assets and Financial Liabilities'*	Inserts application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard. Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement. This amendment is not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2014.
Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – 'Novation of Derivatives and Continuation of Hedge Accounting'*	Provides relief from discontinuing hedge accounting in circumstances where a derivative designated as a hedging instrument is novated to a central counterparty as a consequence or introduction of laws or regulations. These amendments are not expected to have a significant impact on the Group.	Annual periods beginning on or after 1 January 2014.
IFRIC 21 *Levies*[1]	Clarifies that the obligating event that gives rise to a liability to pay a government levy is the activity that triggers the payment of the levy as set out in the relevant legislation. An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period.	Annual periods beginning on or after 1 January 2014.
IFRS 9 *Financial Instruments*[1,2]	Replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the classification, measurement and derecognition of financial assets and liabilities. IFRS 9 requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments and eliminates the available-for-sale financial asset and held-to-maturity investment categories in IAS 39. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income. The hedge accounting requirements are more closely aligned with risk management practices and follow a more principle-based approach.	Date yet to be determined.

[1]As at 6 March 2014, these pronouncements are awaiting EU endorsement.

[2]IFRS 9 is the standard which will replace IAS 39. Further changes to IFRS 9 are expected dealing with impairment of financial assets measured at amortised cost, which will be based on expected rather than incurred credit losses, and limited amendments to classification and measurement which include the introduction of a third measurement category, fair value through other comprehensive income. Until the standard is complete, it is not possible to determine the overall impact of the standard on the financial statements.

56 Approval of financial statements and other information

The consolidated financial statements were approved by the directors of HBOS plc on 6 March 2014.

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

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.