HBOS plc

Report and Accounts
2015

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; and private banking.

Business review

During the year ended 31 December 2015, the Group recorded a profit before tax of £2,740 million compared with a profit before tax in 2014 of £3,550 million. The result in 2015 included provisions in respect of redress to customers relating to both past sales of Payment Protection Insurance and other matters of £1,421 million compared to a charge of £918 million in the year ended 31 December 2014; 2014 also included a past service pension credit of £342 million which was not repeated in 2015. Excluding these items from both years, profit before tax was £35 million, or 1 per cent, higher at £4,161 million in the year ended 31 December 2015 compared to £4,126 million in the previous year.

Total income decreased by £262 million, or 3 per cent, to £7,385 million in 2015 compared with £7,647 million in 2014, comprising a £434 million decrease in other income partly offset by an increase in net interest income.

Net interest income was £6,706 million in 2015; an increase of £172 million, or 3 per cent compared to £6,534 million in 2014 reflecting an improvement in margin. Average interest-earning assets fell as a result of the continued run down of the portfolio of assets which are outside of the Group's risk appetite.

Other income was £434 million, or 39 per cent, lower at £679 million in 2015 compared to £1,113 million in 2014. Fee and commission income was £31 million, or 4 per cent, lower at £806 million compared to £837 million in 2014. Fee and commission expense increased by £43 million, or 15 per cent, to £323 million compared with £280 million in 2014. The decrease in net fee and commission income largely reflects reduced current account and credit card fee income and increased fees payable in respect of commercial transactions. Net trading income decreased by £329 million, or 68 per cent, to £152 million in 2015 compared to £481 million in 2014. Other operating income was £31 million lower at £44 million in 2015 compared to £75 million in 2014.

Operating expenses increased by £847 million, or 23 per cent to £4,452 million in 2015 compared with £3,605 million in 2014; the main reasons for the increase being the £503 million increase in charges for redress payments to customers in respect of PPI and other conduct related matters from £918 million in 2014 to £1,421 million in 2015 and a net past service pension credit of £342 million in 2014 which was not repeated in 2015. Excluding these items from both years, operating expenses were £2 million higher at £3,031 million in 2015 compared to £3,029 million in 2014. On this basis staff costs were £146 million, or 9 per cent, lower at £1,533 million in 2015 compared with £1,679 million in 2014; annual pay rises being more than offset by the impact of headcount reductions resulting from the Lloyds Banking Group's rationalisation programmes and a reduction in severance costs as this phase of the Lloyds Banking Group's Simplification programme draws to a close. Premises and equipment costs were £59 million or 18 per cent, lower at £260 million in 2015 compared with £319 million in 2014. Other expenses, excluding the charges in respect of customer redress provisions, were £212 million, or 25 per cent, higher at £1,064 million in 2015 compared with £852 million in 2014. Depreciation and amortisation costs were £5 million, or 3 per cent, lower at £174 million in 2015 compared to £179 million in 2014.

Impairment losses decreased by £299 million, or 61 per cent, to £193 million in 2015 compared with £492 million in 2014. Impairment losses in respect of loans and advances to customers were £252 million, or 54 per cent, lower at £217 million in 2015 compared with £469 million in 2014. The overall performance of the portfolio reflects a significant reduction in lending which is outside of the Group's risk appetite and improvements across the business. The net charge has also benefited from significant provision releases but at lower levels than seen in 2014. There was a credit of £26 million in respect of undrawn commitments in 2015, compared to a charge of £17 million in 2014, a result of improvements in credit quality in a number of corporate relationships.

In 2015, the Group recorded a tax charge of £729 million compared to a tax charge of £670 million in 2014, an effective tax rate of 26.6 per cent, which was higher than the standard UK corporation tax rate of 20.25 per cent; principally as a result of the disallowance of a substantial proportion of the Group's charge in respect of PPI and other conduct risk issues. The tax charge of £670 million in 2014 arose on a profit before tax of £3,550 million; this tax charge reflected tax exempt gains on the sale of businesses.

On the balance sheet, total assets were £41,777 million, or 11 per cent, lower at £336,002 million at 31 December 2015 compared to £377,779 million at 31 December 2014. Trading and other financial assets at fair value through profit or loss were £9,526 million lower, derivative assets were £8,560 million lower and there was a reduction of £17,177 million in amounts due from fellow Lloyds Banking Group undertakings. Total liabilities were £33,503 million, or 9 per cent, lower at £320,521 million at 31 December 2015 compared to £354,024 million at 31 December 2014. Customer deposits were £12,890 million, or 6 per cent, lower at £190,046 million at 31 December 2015 compared to £202,936 million at 31 December 2014; there were also decreases of £9,354 million in trading and other financial liabilities at fair value through profit or loss and £8,024 million in derivative liabilities. Total equity was £8,274 million, or 35 per cent, lower at £15,481 million at 31 December 2015 compared to £23,755 million at 31 December 2014; this reflects the dividends of £11,500 million paid in the year.

At 31 December 2015, the Group had a common equity tier 1 (CET1) ratio of 11.1 per cent, (31 December 2014: 20.0 per cent) as the impact of the lower capital base (as a result of dividend payments) has more than offset a reduction in risk-weighted assets. Risk-weighted assets reduced by £17,370 million, or 18 per cent, to £79,154 million, at 31 December 2015 compared to £96,524 million at 31 December 2014, primarily driven by reductions in the portfolio of assets which are outside of the Group's risk appetite and continued improvements in credit quality.

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

Capital position at 31 December 2015
The Group's capital position applying CRD IV transitional rates at 31 December 2015 is set out in the following section.

Table 1.1 Capital resources (audited)

Capital resources	At 31 Dec 2015 £m	At 31 Dec 2014[1] £m
Common equity tier 1		
Shareholders' equity per balance sheet	13,944	23,718
Adjustment to retained earnings for foreseeable dividends	(2,000)	–
Regulatory filters:		
Unrealised reserve on available-for-sale securities	–	(158)
Cash flow hedging reserve	(169)	(484)
Other adjustments	(71)	(123)
	11,704	22,953
Less: deductions from common equity tier 1		
Goodwill and other intangible assets	(425)	(423)
Excess of expected losses over impairment provisions and value adjustments	(174)	(328)
Removal of defined benefit pension surplus	(540)	(662)
Securitisation deductions	(166)	(181)
Non-significant investments	(28)	–
Deferred tax assets	(1,606)	(2,097)
Common equity tier 1 capital	8,765	19,262
Additional tier 1		
Additional tier 1 instruments	3,617	2,419
Less: deductions from tier 1		
Non-significant investments	(300)	–
Total tier 1 capital	12,082	21,681
Tier 2		
Tier 2 instruments	3,534	4,080
Eligible provisions	322	385
Less: deductions from tier 2		
Non-significant investments	(566)	–
Total tier 2 capital	3,290	4,465
Total capital resources	15,372	26,146

[1]Restated – see note 1.

Table 1.2 Risk Weighted Assets and Capital Ratios (unaudited)

	At 31 Dec 2015 £m	At 31 Dec 2014[1] £m
Risk-weighted assets	79,154	96,524
Common equity tier 1 capital ratio	11.1%	20.0%
Tier 1 capital ratio	15.3%	22.5%
Total capital ratio	19.4%	27.1%

[1] Restated – see note 1.

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

Credit risk
Principal risks
The risk that customers to whom we have lent money or other counterparties with whom we have contracted, fail to meet their financial obligations, resulting in loss to the Group.

Adverse changes in the economic and market environment we operate in or the credit quality and/or behaviour of our customers and counterparties could reduce the value of our assets and potentially increase our write downs and allowances for impairment losses, adversely impacting profitability.

Mitigating actions
Credit policy, incorporating prudent lending criteria, aligned with the Lloyds Banking Group Board approved risk appetite, to effectively manage risk.

Robust risk assessment and credit sanctioning, with clearly defined levels of authority to ensure we lend appropriately and responsibly.

Extensive and thorough credit processes and controls to ensure effective risk identification, management and oversight.

Effective, well-established governance process supported by independent credit risk assurance.

Early identification of signs of stress leading to prompt action in engaging the customer.

Regulatory and legal risk
Principal risks
The risks of changing legislation, regulation, policies and voluntary codes of practice and their interpretation in the markets in which we operate can have a significant impact on the Group's operations, business prospects, structure, costs and/or capital requirements and ability to enforce contractual obligations.

Mitigating actions
The Lloyds Banking Group Legal, Regulatory and Mandatory Change Committee ensures we develop plans for delivery of all legal and regulatory changes and tracks their progress. Lloyds Banking Group, Groupwide projects implemented to address significant impacts.

Continued investment in people, processes, training and IT to assess impact and help meet our legal and regulatory commitments.

Engage with regulatory authorities and relevant industry bodies on forthcoming regulatory changes, market reviews and Competition and Markets Authority investigations.

Conduct risk
Principal risks
Conduct risk can arise from a number of areas including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; and exhibiting behaviours which do not meet market or regulatory standards.

Mitigating actions
Customer focused conduct strategy implemented to ensure customers are at the heart of everything we do.

Product approval, review processes and outcome testing supported by conduct management information.

Clear customer accountabilities for colleagues, with rewards driven by customer-centric metrics.

Learning from past mistakes through root-cause analysis of crystallised issues.

Operational risk
Principal risks
We face significant operational risks which may result in financial loss, disruption or damage to our reputation. These include the availability, resilience and security of our core IT systems and the potential for failings in our customer processes.

Mitigating actions
Continual review of our IT environment to ensure that systems and processes can effectively support the delivery of services to customers.

Addressing the observations and associated resilience risks raised in the Independent IT Resilience Review (2013) of Lloyds Banking Group, with independent verification of progress on an annual basis.

Investing in enhanced cyber controls to protect against external threats to the confidentiality or integrity of electronic data, or the availability of systems. Responding to findings from third party industry testing.

People risk
Principal risks
Key people risks include the risk that we fail to lead responsibly in an increasing competitive marketplace, particularly with the introduction of the Senior Managers' and Certification Regime (SM&CR) in 2016. This may dissuade capable individuals from taking up senior positions within the industry.

Mitigating actions
Focused action on strategy to attract, retain and develop high calibre people.

Maintain compliance with legal and regulatory requirements relating to the SM&CR, embedding compliant and appropriate colleague behaviours.

Continued focus on the Group's culture, delivering initiatives which reinforce behaviours to generate the best long-term outcomes for customers and colleagues.

Maintain organisational people capability and capacity levels in response to increasing volumes of organisational and external market changes.

Capital risk
Principal risks
The risk that we have a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group.

Mitigating actions
A comprehensive capital management framework that sets and monitors capital risk appetite using a number of key metrics.

Close monitoring of capital and leverage ratios to ensure we meet current and future regulatory requirements.

Comprehensive stress testing analysis to evidence sufficient levels of capital adequacy under various adverse scenarios.

Accumulation of retained profits and managing dividend policy appropriately.

Funding and liquidity risk
Principal risks
The risk that we have insufficient financial resources to meet our commitments as they fall due, or can only secure them at excessive cost.

Mitigating actions
Holding a large portfolio of unencumbered LCR eligible liquid assets to meet cash and collateral outflows and regulatory requirements and maintaining a further large pool of secondary assets that can be used to access central bank liquidity facilities.

Undertaking daily monitoring against a number of market and Lloyds Banking Group specific early warning indicators and regular stress tests.Maintaining a contingency funding plan detailing management actions and strategies available in stressed conditions.

Governance risk
Principal risks
Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from the SM&CR in force from March 2016 and the requirement to improve the resolvability of the Group and to ring-fence core UK financial services and activities from January 2019.

Mitigating actions
Our response to the SM&CR is managed through a programme with work streams addressing each of the major components.

A programme is in place to address the requirements of ring-fencing and resolution and we are in close and regular contact with regulators to develop plans for our anticipated operating and legal structures.

Our aim is to ensure that evolving risk and governance arrangements continue to be appropriate across the range of business in the Group in order to comply with regulatory objectives.

Market risk
Principal risks
The risk that the Group's capital or earnings profile is affected by adverse market rates, in particular interest rates and credit spreads in the Banking business, equity and credit spreads in Insurance business and the Group's Defined Benefit Pension Schemes.

Mitigating actions
Structural hedge programmes have been implemented to manage liability margins and margin compression, and the Group's exposure to Bank Base Rate.

Equity and credit spread risks are inherent within Insurance products and are closely monitored to ensure they remain within risk appetite. Where appropriate, asset liability matching is undertaken to mitigate risk.

The allocation to credit assets has been increased and equity holdings reduced within the Group's Defined Benefit Pension Schemes. A hedging programme is also in place to minimise exposure to nominal rates/inflation.

Stress and scenario testing of the Group's risk exposures.

Financial risk management objectives and policies
The Group's approach to risk management including risk policies, risk appetite, measurement bases and sensitivities, in particular for credit risk, market risk and liquidity risk, is aligned to those of Lloyds Banking Group plc, the Company's ultimate parent. Further information can be found in the Lloyds Banking Group plc annual report. Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in note 43.

The 2015 Strategic Report has been approved by the Board of Directors.

On behalf of the Board

Lord Blackwell
HBOS plc
16 March 2016

Directors' report

Results
The consolidated income statement on page 13 shows a statutory profit before tax for the year ended 31 December 2015 of £2,740 million (year ended 31 December 2014: £3,550 million).

Dividends
During the year the Company paid interim dividends totalling £11,500 million (2014: £1,500 million). The Directors have not recommended a dividend for the year ended 31 December 2015 (2014: £nil).

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 the principal risks and uncertainties and capital positions set out in the strategic report on pages 2 to 5 and additionally have considered projections for the Group's capital and funding position. Accordingly, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the accounts over the next 12 months.

Directors
The names of the current Directors are shown on page 9. Changes to the composition of the Board since 1 January 2015 up to the date of this report are shown in the table below:

	Joined the Board	Retired from the Board
Carolyn Fairbairn		31 October 2015
Deborah McWhinney	1 December 2015	
Stuart Sinclair	4 January 2016	

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' indemnities
The Directors of the Company, including the former Director who retired during the year, have entered into individual deeds of indemnity with Lloyds Banking Group plc which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force for the duration of a Director's period of office. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the Director appointed in 2015. Revisions are being made to the existing Deeds of Indemnity to take account of the Senior Managers and Certification Regime. Deeds for existing Directors are available for inspection at the Company's registered office.

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 Group's subsidiary companies, including to former Directors who retired during the year and since the year end. Qualifying pension scheme indemnities were also granted to the Trustees of Lloyds Banking Group's Pension Schemes.

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.

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

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

– the Directors are required to complete a conflicts questionnaire on appointment and annually thereafter;

– changes to the commitments of all Directors are reported to the Nomination & Governance Committee and the Board; and

– a register of potential conflicts and time commitments is regularly reviewed and authorised by the Board to ensure the authorisation status remains appropriate.

If any potential conflict arises, the articles of association permit the Board to authorise the conflict, subject to such conditions or limitations as the Board may determine.

Stuart Sinclair is a Non-Executive Director of Provident Financial Plc, a supplier of personal credit products to the non-standard lending market, and Senior Independent Director at both QBE Insurance (Europe) Limited, a general insurance and reinsurance company, and Swinton Group Limited, an insurance broker for home and motor insurance. The Board has recognised that potential conflicts may arise in relation to his position at QBE Insurance and in relation to Swinton Group. The Board has authorised the potential conflicts and requires Mr Sinclair to recuse himself from discussions, should the need arise. Prior to Carolyn Fairbairn's retirement from the Board, she was also a Non-Executive Director of the Competition and Markets Authority (CMA). During the period she served on the Board, she recused herself from all discussions at the CMA on their investigation into banking competition.

Branches, future developments and financial risk management objectives and policies
The Company provides a wide range of banking and financial services through branches and offices in the UK and overseas. Information regarding future developments and financial risk management objectives and policies of the Group in relation to the use of financial instruments that would otherwise be required to be disclosed in the directors' report, and which is incorporated into this report by reference, can be found in the strategic report.

Share capital
Information about share capital is shown in note 34 on page 58. This information is incorporated into this report by reference.

The Company did not repurchase any of its shares during the year (2014: 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 manage the business of the Company under the powers set out in the Companies Act 2006 and the Company's articles of association, these powers include those in relation to the issue or buy back of the Company's shares.

Share premium account
During the year, the Company reduced its share premium account. Details can be found in note 35 on page 59.

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.

Employees
The Company, as part of Lloyds Banking Group, provides colleagues with information on the Group's performance and matters that concern their role, for example changes in the economic or regulatory environment, management changes and reward and remuneration. Colleagues are regularly consulted and share their views twice a year through our 'best bank for customers' and 'building the best team' colleague surveys. The results of these surveys were shared across the organisation, with over 4,000 line managers holding survey results conversations with their teams to agree actions to deliver our vision of becoming the best bank for customers. Colleagues are offered share schemes as part of wider incentive arrangements, and to encourage their financial involvement.

In building a culture in which colleagues are empowered, inspired and incentivised to do the right thing for customers, the Group assesses progress, along with colleagues' pride in the Group through the 'best bank for customers' and 'building the best team' surveys. In 2015, 85 per cent of colleagues responded to the latter. A new statement was included in 2015, 'I understand how my team is supporting the Group's purpose to Helping Britain Prosper' where 81 per cent of colleagues agreed. This regular dialogue with colleagues provides rich data and a clear picture of how they're feeling.

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

The Group aims to appoint the best person available into any role and to attract talented people from diverse backgrounds. The Group encourages and gives full and fair consideration to job applications from people with a disability and are unbiased in the way it assesses, selects, appoints, trains and promotes people. The Group encourages job applications from those with a disability and continue to run a work experience programme with Remploy to support people with disabilities wanting to enter the workplace. All colleagues, including disabled colleagues, are provided with training and development opportunities so that they can carry out their role to the best of their ability. All line managers completed inclusion and diversity capability training in 2015, and an additional 200 Group colleagues were trained to deliver disability awareness sessions with customers. Lloyds Banking Group's award-winning workplace adjustment programme, which provides physical and non-physical adjustments to all colleagues including disabled colleagues, carried out more than 6,300 adjustments in 2015, bringing the total to 28,000 since the programme started in 2002. Lloyds Banking Group retained its Gold Standard in the Business Disability Forum Benchmark with a score of 98. The Disability Standard establishes what best practice is across the business in terms of disability performance and recognises the adjustments the Group has made for employees, candidates and customers as part of the Lloyds Banking Group Disability Programme.

Significant contracts
Details of related party transactions are set out in note 41 on pages 64 to 67.

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, who are in office and whose names are shown on page 9 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 and the profit or loss of the Company and 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.

Directors' report

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 strategic report.

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

A resolution will be proposed at the 2016 annual general meeting to re-appoint PricewaterhouseCoopers LLP as auditor. The Company's Audit Committee is satisfied that the external auditor remains independent and effective.

On behalf of the Board

Malcolm Wood
Company Secretary
16 March 2016

HBOS plc
Registered in Scotland
Company Number SC218813

Directors

Lord Blackwell *Chairman*

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

George Culmer *Executive Director and Chief Financial Officer*

Juan Colombás *Executive Director and Chief Risk Officer*

Alan Dickinson

Anita Frew

Simon Henry

Dyfrig John CBE

Nick Luff

Deborah McWhinney

Nick Prettejohn

Stuart Sinclair

Anthony Watson CBE

Sara Weller

Forward looking statements

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

Examples of such forward looking statements include, but are not limited to: projections or expectations of the HBOS Group's future financial position including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the HBOS Group's future financial performance; the level and extent of future impairments and write-downs; statements of plans, objectives or goals of the HBOS Group or its management including in respect of statements about the future business and economic environments in the UK and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the HBOS Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the HBOS Group's or Lloyds Banking Group plc's or Lloyds Bank plc's credit ratings; the ability to derive cost savings; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, the potential for one or more countries to exit the Eurozone or European Union (EU) (including the UK as a result of a referendum on its EU membership) and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to cyber security; natural, pandemic and other disasters, adverse weather and similar contingencies outside the HBOS Group's or Lloyds Banking Group plc's or Lloyds Bank plc's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, accounting standards or taxation, including as a result of further Scottish devolution; changes to regulatory capital or liquidity requirements and similar contingencies outside the HBOS Group's or Lloyds Banking Group plc's or Lloyds Bank plc's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation; the ability to attract and retain senior management and other employees; requirements or limitations on Lloyds Banking Group plc, Lloyds Bank plc and the HBOS Group as a result of HM Treasury's investment in Lloyds Banking Group plc; actions or omissions by the HBOS Group's directors, management or employees including industrial action; changes to the HBOS Group's post-retirement defined benefit scheme obligations; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the HBOS Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc 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 the HBOS Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this Annual Report to reflect any change in the 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 2015 and of the Group's profit and the Group's and the 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.

What we have audited

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

- the Balance sheets as at 31 December 2015;
- the Consolidated income statement and Statements of comprehensive income for the year then ended;
- the Cash flow statements for the year then ended;
- the Statements of changes in equity for the year then ended; and
- the notes to the accounts, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the Company financial statements, 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.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion:

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

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 Group or Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Group's or Company's 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 to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

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

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards On Auditing (UK & Ireland) ("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 Group's and Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

We conducted our audit in accordance with 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 the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

Independent auditors' report

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

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

16 March 2016

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

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

Consolidated income statement

for the year ended 31 December 2015

	Note	**2015** **£ million**	2014[1] £ million
Interest and similar income		**10,459**	11,448
Interest and similar expense		**(3,753)**	(4,914)
Net interest income	5	**6,706**	6,534
Fee and commission income		**806**	837
Fee and commission expense		**(323)**	(280)
Net fee and commission income	6	**483**	557
Net trading income	7	**152**	481
Other operating income	8	**44**	75
Other income		**679**	1,113
Total income		**7,385**	7,647
Regulatory provisions		**(1,421)**	(918)
Other operating expenses		**(3,031)**	(2,687)
Total operating expenses	9	**(4,452)**	(3,605)
Trading surplus		**2,933**	4,042
Impairment	10	**(193)**	(492)
Profit before tax		**2,740**	3,550
Taxation	11	**(729)**	(670)
Profit for the year		**2,011**	2,880
Profit attributable to non-controlling interests		**–**	–
Profit attributable to equity shareholders		**2,011**	2,880
Profit for the year		**2,011**	2,880

[1]Restated – see note 1.

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

Statements of comprehensive income

for the year ended 31 December 2015

The Group	2015 £ million	2014[1] £ million
Profit for the year	**2,011**	2,880
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before taxation	**(143)**	444
Taxation	**27**	(89)
	(116)	355
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	**(16)**	250
Income statement transfers in respect of disposals	**(37)**	(137)
Income statement transfers in respect of impairment	**38**	8
Taxation	**2**	(1)
	(13)	120
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**181**	(55)
Net income statement transfers	**(554)**	(474)
Taxation	**58**	106
	(315)	(423)
Currency translation differences (tax: nil)	**70**	1
Other comprehensive income for the year, net of tax	**(374)**	53
Total comprehensive income for the year	**1,637**	2,933
Total comprehensive income attributable to non-controlling interests	**–**	–
Total comprehensive income attributable to equity shareholders	**1,637**	2,933
Total comprehensive income for the year	**1,637**	2,933

The Company	2015 £ million	2014 £ million
Profit for the year	**9,398**	31
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before taxation	**(169)**	488
Taxation	**27**	(98)
	(142)	390
Items that may subsequently be reclassified to profit or loss:		
Currency translation differences (tax: nil)	**(15)**	–
Other comprehensive income for the year, net of tax	**(157)**	390
Total comprehensive income for the year	**9,241**	421

[1] Restated – see note 1.

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

Consolidated balance sheet

at 31 December 2015

	Note	2015 £ million	2014[1] £ million
Assets			
Cash and balances at central banks		**2,481**	5,110
Items in the course of collection from banks		**172**	375
Trading and other financial assets at fair value through profit or loss	12	**5,828**	15,354
Derivative financial instruments	13	**14,926**	23,486
Loans and receivables:			
Loans and advances to banks	14	**691**	746
Loans and advances to customers	15	**270,837**	271,673
Debt securities		**182**	219
Due from fellow Lloyds Banking Group undertakings		**31,560**	48,737
		303,270	321,375
Available-for-sale financial assets	19	**4,557**	5,567
Goodwill	21	**325**	325
Other intangible assets	22	**102**	100
Property, plant and equipment	23	**1,192**	1,317
Current tax recoverable		**–**	4
Deferred tax assets	31	**1,941**	2,226
Retirement benefit assets	30	**675**	828
Other assets	24	**533**	1,712
Total assets		**336,002**	377,779

[1] Restated – see note 1.

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

Consolidated balance sheet

at 31 December 2015

	Note	**2015 £ million**	2014[1] £ million
Equity and liabilities			
Liabilities			
Deposits from banks	25	**1,541**	2,291
Customer deposits	26	**190,046**	202,936
Due to fellow Lloyds Banking Group undertakings		**80,047**	78,647
Items in course of transmission to banks		**342**	275
Trading and other financial liabilities at fair value through profit or loss	27	**4,415**	13,769
Derivative financial instruments	13	**12,744**	20,768
Notes in circulation		**1,112**	1,129
Debt securities in issue	28	**18,492**	20,408
Other liabilities	29	**1,046**	1,745
Retirement benefit obligations	30	**188**	226
Current tax liabilities		**345**	501
Other provisions	32	**1,899**	1,546
Subordinated liabilities	33	**8,304**	9,783
Total liabilities		**320,521**	354,024
Equity			
Share capital	34	**3,763**	3,763
Share premium account	35	–	18,655
Other reserves	36	**10,479**	10,737
Retained profits	37	**(298)**	(9,437)
Shareholders' equity		**13,944**	23,718
Other equity instruments	38	**1,500**	–
Total equity excluding non-controlling interests		**15,444**	23,718
Non-controlling interests		**37**	37
Total equity		**15,481**	23,755
Total equity and liabilities		**336,002**	377,779

[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 16 March 2016.

Lord Blackwell
Chairman

António Horta-Osório
Chief Executive

George Culmer
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 December 2015

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2014[1]	22,418	11,039	(11,308)	22,149	–	49	22,198
Comprehensive income							
Profit for the year[1]	–	–	2,880	2,880	–	–	2,880
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	355	355	–	–	355
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	120	–	120	–	–	120
Movements in cash flow hedging reserve, net of tax	–	(423)	–	(423)	–	–	(423)
Currency translation differences, net of tax	–	1	–	1	–	–	1
Total other comprehensive income	–	(302)	355	53	–	–	53
Total comprehensive income[1]	–	(302)	3,235	2,933	–	–	2,933
Transactions with owners							
Dividends	–	–	(1,500)	(1,500)	–	–	(1,500)
Capital contribution received	–	–	136	136	–	–	136
Change in non-controlling interests	–	–	–	–	–	(12)	(12)
Total transactions with owners	–	–	(1,364)	(1,364)	–	(12)	(1,376)
Balance at 31 December 2014[1]	22,418	10,737	(9,437)	23,718	–	37	23,755
Comprehensive income							
Profit for the year	**–**	**–**	**2,011**	**2,011**	**–**	**–**	**2,011**
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**(116)**	**(116)**	**–**	**–**	**(116)**
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	**–**	**(13)**	**–**	**(13)**	**–**	**–**	**(13)**
Movements in cash flow hedging reserve, net of tax	**–**	**(315)**	**–**	**(315)**	**–**	**–**	**(315)**
Currency translation differences, net of tax	**–**	**70**	**–**	**70**	**–**	**–**	**70**
Total other comprehensive income	**–**	**(258)**	**(116)**	**(374)**	**–**	**–**	**(374)**
Total comprehensive income	**–**	**(258)**	**1,895**	**1,637**	**–**	**–**	**1,637**
Transactions with owners							
Dividends	**–**	**–**	**(11,500)**	**(11,500)**	**–**	**–**	**(11,500)**
Capital contribution received	**–**	**–**	**89**	**89**	**–**	**–**	**89**
Repayment of capital contribution	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Capital restructuring	**(18,655)**	**–**	**18,655**	**–**	**–**	**–**	**–**
Issue of additional Tier 1 securities	**–**	**–**	**–**	**–**	**1,500**	**–**	**1,500**
Change in non-controlling interests	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total transactions with owners	**(18,655)**	**–**	**7,244**	**(11,411)**	**1,500**	**–**	**(9,911)**
Balance at 31 December 2015	**3,763**	**10,479**	**(298)**	**13,944**	**1,500**	**37**	**15,481**

[1]Restated – see note 1.

Further details of movements in the Group's share capital and reserves are provided in notes 34, 35, 36 and 37.

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

Consolidated cash flow statement

for the year ended 31 December 2015

	Note	2015 £ million	2014[1] £ million
Profit before tax		**2,740**	3,550
Adjustments for:			
Change in operating assets	48(a)	**40,282**	184,734
Change in operating liabilities	48(b)	**(32,171)**	(179,912)
Non-cash and other items	48(c)	**(1,678)**	(5,881)
Tax paid		**(460)**	(489)
Net cash provided by (used in) operating activities		**8,713**	2,002
Cash flows from investing activities			
Purchase of available-for-sale financial assets		**(11,368)**	(4,436)
Proceeds from sale and maturity of available-for-sale financial assets		**12,017**	2,215
Purchase of fixed assets		**(136)**	(144)
Proceeds from sale of fixed assets		**92**	678
Acquisition of businesses, net of cash acquired		**(5)**	(1)
Disposal of businesses, net of cash disposed	48(e)	**22**	76
Net cash (used in) provided by investing activities		**622**	(1,612)
Cash flows from financing activities			
Dividends paid to ordinary shareholders	39	**(11,500)**	(1,500)
Issue of additonal Tier 1 securities		**1,500**	–
Interest paid on subordinated liabilities		**(474)**	(544)
Repayment of subordinated liabilities	33	**(1,310)**	(1,453)
Net cash used in financing activities		**(11,784)**	(3,497)
Effects of exchange rate changes on cash and cash equivalents		**2**	(1)
Change in cash and cash equivalents		**(2,447)**	(3,108)
Cash and cash equivalents at beginning of year		**4,839**	7,947
Cash and cash equivalents at end of year	48(d)	**2,392**	4,839

[1]Restated – see note 1.

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

Company balance sheet

at 31 December 2015

	Note	2015 £ million	2014 £ million
Assets			
Amounts owed by Group entities		**16,082**	18,448
Derivative financial instruments	13	**586**	642
Retirement benefit assets	30	**675**	828
Other assets	24	**–**	1
Investments in subsidiary undertakings	20	**22,206**	22,365
Total assets		**39,549**	42,284
Liabilities			
Amounts owed to Group entities		**10,286**	9,735
Other liabilities	29	**529**	486
Current tax liabilities		**36**	39
Retirement benefit obligations	30	**169**	168
Deferred tax liabilities	31	**138**	154
Subordinated liabilities	33	**5,958**	7,111
Total liabilities		**17,116**	17,693
Equity			
Issued share capital	34	**3,763**	3,763
Share premium account	35	**–**	18,655
Other reserves	36	**9,678**	9,693
Retained profits	37	**8,992**	(7,520)
Shareholders' equity		**22,433**	24,591
Total equity and liabilities		**39,549**	42,284

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

Approved by the Board on 16 March 2016 and signed on its behalf by:

Lord Blackwell	**António Horta-Osório**	**George Culmer**
Chairman	Chief Executive	Chief Financial Officer

Company statement of changes in equity

for the year ended 31 December 2015

	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million
Balance at 1 January 2014	22,418	9,693	(6,720)	25,391
Comprehensive income				
Profit for the year	–	–	31	31
Other comprehensive income				
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	390	390
Total comprehensive income	–	–	421	421
Transactions with owners				
Capital contribution received	–	–	279	279
Dividends paid	–	–	(1,500)	(1,500)
Total transactions with owners	–	–	(1,221)	(1,221)
Balance at 31 December 2014	22,418	9,693	(7,520)	24,591
Comprehensive income				
Profit for the year	**–**	**–**	**9,398**	**9,398**
Other comprehensive income				
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**(142)**	**(142)**
Currency translation differences, net of tax	**–**	**(15)**	**–**	**(15)**
Total comprehensive income	**–**	**(15)**	**9,256**	**9,241**
Transactions with owners				
Capital contribution received	**–**	**–**	**101**	**101**
Capital restructuring	**(18,655)**	**–**	**18,655**	**–**
Dividends paid	**–**	**–**	**(11,500)**	**(11,500)**
Total transactions with owners	**(18,655)**	**–**	**7,256**	**(11,399)**
Balance at 31 December 2015	**3,763**	**9,678**	**8,992**	**22,433**

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

Company cash flow statement

for the year ended 31 December 2015

	Note	2015 £ million	2014 £ million
Profit before tax		**9,406**	150
Adjustments for:			
Change in operating assets		**765**	8,401
Change in operating liabilities		**594**	(12,980)
Non-cash and other items		**569**	357
Tax paid		**–**	(97)
Net cash used in operating activities		**11,334**	(4,169)
Cash flows from financing activities			
Dividends paid to ordinary shareholders	39	**(11,500)**	(1,500)
Repayment of subordinated liabilities	33	**(1,063)**	(1,203)
Interest paid on subordinated liabilities		**(329)**	(374)
Net cash used in financing activities		**(12,892)**	(3,077)
Change in cash and cash equivalents		**(1,558)**	(7,246)
Cash and cash equivalents at beginning of year		**10,220**	17,466
Cash and cash equivalents at end of year		**8,662**	10,220

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

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 IFRS Interpretations Committee (IFRS IC) and its predecessor body. The EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB. The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

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 risk on page 5 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.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2015 and which have not been applied in preparing these financial statements are given in note 49.

During 2015, the Company identified an error in a subsidiary's accounting for an intra-group hedging transaction and has applied the correcting entries retrospectively. The effect on the Group has been to decrease total assets by £51 million (from £557,695 million to £557,644 million), decrease total liabilities by £365 million (from £535,811 million to £535,446 million) and increase retained earnings by £314 million (from £(11,622) million to £(11,308) million) at 1 January 2014; decrease interest expense by £220 million and increase the tax charge by £44 million for the year ended 31 December 2014; and reduce an intra-Lloyds Banking Group payable by £618 million, decrease deferred tax assets by £95 million and increase current tax liabilities by £33 million at 31 December 2014.

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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. Details of the Group's subsidiaries and related undertakings are given on pages 99 to 103.

(1) Subsidiaries

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

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

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

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

The acquisition method of accounting is used to account for business combinations by the Group. The consideration for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred except those relating to the issuance of debt instruments (see 2e(4)) or share capital (see 2p(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 joint arrangements over which the Group has joint control under a contractual arrangement with other parties and has rights to the net assets of the arrangements. 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 but is not control or joint control of those policies and is generally achieved through holding between 20 per cent and 50 per cent of the voting share capital of the entity.

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated at initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Group's share of the post-acquisition results of the joint venture or associate based on accounts which are coterminous with the Group or made up 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.

2 Accounting policies (continued)

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

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

c Other intangible assets
Other intangible assets include brands, purchased credit card relationships 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
Purchased credit card relationships	5 years

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

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

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

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

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

Revenue recognition policies relating to leases are set out in j(2) below.

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

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

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

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

(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.

2 Accounting policies (continued)

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 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 43(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

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

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

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

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

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

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

(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.

2 Accounting policies (continued)

(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 43(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

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

Derivatives embedded in financial instruments 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.

The method of recognising the movements in the fair value of derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item, the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the 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. Cash collateral on exchange traded derivative transactions is presented gross unless the collateral cash flows are always settled net with the derivative cash flows. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

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

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

2 Accounting policies (continued)

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

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

Individual assessment

In respect of individually significant financial assets in the Group's commercial lending portfolios, assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed on a 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 could lead to the initial recognition of impairment allowances against lending to corporate borrowers (or the recognition of additional impairment allowances) include (i) trading losses, loss of business or major customer of a borrower; (ii) material breaches of the terms and conditions of a loan facility, including non-payment of interest or principal, or a fall in the value of security such that it is no longer considered adequate; (iii) disappearance of an active market because of financial difficulties; or (iv) restructuring a facility with preferential terms to aid recovery of the lending (such as a debt for equity swap).

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

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

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 commercial lending they include factors such as observed default rates and loss given default. An assessment is made of the likelihood of each account becoming recognised as impaired within the loss emergence period, with the economic loss that each portfolio is likely to generate were it to become impaired. The loss emergence period is determined by local management for each portfolio and the Group has a range of loss emergence periods which are dependent upon the characteristics of the portfolios. Loss emergence periods are reviewed regularly and updated when appropriate. In general the periods used across the Group vary between one month and twelve months based on historical experience. Unsecured portfolios tend to have shorter loss emergence periods than secured portfolios.

Loan renegotiations and forbearance

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

2 Accounting policies (continued)

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

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

(2) Available-for-sale financial assets
The Group assesses, at each balance sheet date, whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer, assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether there has been a significant or prolonged decline in the fair value of the asset below its cost. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised, is reclassified from equity to the income statement. For impaired debt instruments, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows; a reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to other comprehensive income. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

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

Premises (excluding land):

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

Equipment:

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

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

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

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital appreciation or both. 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 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.

2 Accounting policies (continued)

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

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

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

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

The Group's income statement charge includes the current service cost of providing pension benefits, past service costs, net interest expense (income), and plan administration costs that are not deducted from the return on plan assets. Past service costs, which represents the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment, are recognised when the plan amendment or curtailment occurs. Net interest expense (income) is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset.

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

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes. In assessing whether a surplus is recoverable, the Group considers its current right to obtain a refund or a reduction in future contributions and does not anticipate any future acts by other parties that could change the amount of the surplus that may ultimately be recovered.

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

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

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

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

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

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

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

n 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.

2 Accounting policies (continued)

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

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

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

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

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

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.

p 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.

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

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

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3 Critical accounting estimates and judgements

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

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

Allowance for impairment losses on loans and receivables
At 31 December 2015 the Group's gross loans and receivables totalled £306,193 million (2014: £327,201 million) against which impairment allowances of £2,923 million (2014: £5,826 million) had been made (see note 18). The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2(h)(1); this note also provides an overview of the methodologies applied.

The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. In determining the required level of impairment provisions, the Group uses the output from various statistical models. Management judgement is required to assess the robustness of the outputs from these models and, where necessary, make appropriate adjustments. Impairment allowances are made up of two components, those determined individually and those determined collectively.

Individual impairment allowances are generally established against the Group's commercial lending portfolios. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer, and the value of the security held, for which there may not be a readily accessible market. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

3 Critical accounting estimates and judgements (continued)

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

Given the relative size of the mortgage portfolio, a key variable is house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices were ten per cent lower than those estimated at 31 December 2015, the impairment charge would increase by approximately £208 million in respect of UK mortgages.

In addition, a collective unidentified impairment provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. Management use a significant level of judgement when determining the collective unidentified impairment provision, including the assessment of the level of overall risk existing within particular sectors and the impact of the low interest rate environment on loss emergence periods. In the Commercial Banking division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unidentified impairment provisions would result in an increase in the collective unidentified impairment provision of approximately £8 million (at 31 December 2014, a one month increase in the loss emergence period would have increased the collective unidentified impairment provision by an estimated £18 million).

Payment protection insurance and other regulatory provisions

At 31 December 2015, the Group carried provisions of £1,658 million (2014: £1,240 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches, principally the mis-selling of payment protection insurance (2015: £1,210 million; 2014: £918 million). The Group's accounting policy in respect of these provisions is set out in note 2(o).

Determining the amount of the provisions, which represent management's best estimate of the cost of settling these issues, requires the exercise of significant judgement. It will often be necessary to form a view on matters which are inherently uncertain, such as the scope of reviews required by regulators, the number of future complaints, the extent to which they will be upheld, the average cost of redress and the impact of legal decisions that may be relevant to claims received. Consequently the continued appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and other relevant evidence and adjustments made to the provisions where appropriate.

Note 32 contains more detail on the nature of the assumptions that have been made and key sensitivities.

Defined benefit pension scheme obligations

The net asset recognised in the balance sheet at 31 December 2015 in respect of the Group's defined benefit pension scheme obligations was £579 million (comprising an asset of £675 million and a liability of £96 million) (2014: a net asset of £693 million comprising an asset of £828 million and a liability of £135 million). The net asset recognised in the balance sheet at 31 December 2015 in respect of the Company's defined benefit pension scheme obligations was £598 million (comprising an asset of £675 million and a liability of £77 million) (2014: a net asset of £751 million comprising an asset of £828 million and a liability of £77 million).The Group's accounting policy for its defined benefit pension scheme obligations is set out in note 2(k).

The value of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds with the currency and term of the corporate bonds consistent with the defined benefit pension schemes' obligations. The average duration of the schemes' obligations is approximately 20 years. The market for bonds with a 20 year duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate. The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Following the completion of the latest triennial funding valuations, the Group has updated its demographic assumptions for both current mortality expectations and the rate of future mortality improvement. However, given the advances in medical science in recent years, it is uncertain whether this rate of improvement will be sustained going forward and, as a result, actual experience may differ from current expectations. The effect on the net accounting surplus or deficit and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions is set out in note 30.

Fair value of financial instruments

At 31 December 2015, the carrying value of the Group's financial instrument assets held at fair value was £25,311 million (2014: £44,407 million), and its financial instrument liabilities held at fair value was £17,176 million (2014: £34,558 million). Included within these balances are derivative assets of £14,926 million (2014: £23,486 million) and derivative liabilities of £12,744 million (2014: £20,768 million). The Group's accounting policy for its financial instruments is set out in note 2(e) and 2(f).

In accordance with IFRS 13 Fair Value Measurement, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and, in particular, level 3 is determined using valuation techniques including discounted cash flow analysis and valuation models. In addition, in line with market practice, the Group applies credit, debit and funding valuation adjustments in determining the fair value of its uncollateralised derivative positions. A description of these adjustments is set out in note 43, on page 70. These valuation techniques involve management judgement and estimates the extent of which depends on the complexity of the instrument and the availability of market observable information. Valuation techniques for level 2 financial instruments use inputs that are based on observable market data. Level 3 financial instruments are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Determining the appropriate assumptions to be used for level 3 financial instruments requires significant management judgement. Further details of the Group's level 3 financial instruments and the sensitivity of their valuation including the effect of applying reasonably possible alternative assumptions in determining their fair value are set out in note 43.

Recoverability of deferred tax assets

At 31 December 2015 the Group carried deferred tax assets on its balance sheet of £1,941 million (2014: £2,226 million) and deferred tax liabilities of £nil (2014: £nil) (note 31). At 31 December 2015 the Company carried a deferred tax liability on its balance sheet of £138 million (2014: £154 million). 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 31 presents the Group's deferred tax assets and liabilities by type. The largest category of deferred tax asset relates to tax losses carried forward.

3 Critical accounting estimates and judgements (continued)

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

In making this assessment account is taken of business plans, the board approved operating plan and the expected future economic outlook, as well as the risks associated with future regulatory change.

The Group's total deferred tax asset includes £1,661 million (2014: £2,212 million) in respect of trading losses carried forward. The tax losses have arisen in individual legal entities and will be used as future taxable profits arise in those legal entities, though substantially all of the unused tax losses for which a deferred tax asset has been recognised arise in Bank of Scotland plc.

The deferred tax asset is expected to be utilised over different time periods in each of the entities in which the losses arise. Under current UK tax law there is no expiry date for unused tax losses. Following the enactment of the Finance Act 2015, there is now a restriction imposed on the amount of banks' profits that can be offset by certain carried forward tax losses for the purposes of calculating corporation tax liabilities. The losses are expected to be fully utilised by 2025.

As disclosed in note 31, deferred tax assets totalling £200 million (2014: £273 million) have not been recognised in respect of certain capital losses carried forward, trading losses carried forward and unrelieved foreign tax credits as there are no predicted future capital or taxable profits against which these losses can be recognised.

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 the strategic review. The ultimate parent undertaking, Lloyds Banking Group plc, produces consolidated accounts which set out the basis of the segments through which it manages performance and allocates resources across the consolidated Lloyds Banking Group.

Following the 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			
	2015 %	2014[1] %	**2015 £m**	2014[1] £m
Interest and similar income:				
Interest receivable on loans and receivables	**3.19**	2.84	**10,379**	11,393
Available-for-sale financial assets	**1.66**	1.19	**80**	55
Total interest and similar income	**3.17**	2.82	**10,459**	11,448
Interest and similar expense:				
Deposits from banks and customer deposits	**1.20**	1.21	**(3,157)**	(4,229)
Debt securities in issue	**0.84**	0.76	**(166)**	(176)
Subordinated liabilities	**4.98**	4.77	**(430)**	(509)
Total interest and similar expense	**1.29**	1.28	**(3,753)**	(4,914)
Net interest income			**6,706**	6,534

[1]Restated – see note 1.

Included within interest and similar income is £125 million (2014: £236 million) in respect of impaired financial assets. Net interest income also includes a credit of £554 million (2014: credit of £474 million) transferred from the cash flow hedging reserve (see note 36).

6 Net fee and commission income

	2015 £m	2014 £m
Fee and commission income:		
Current accounts	**242**	268
Credit and debit card fees	**233**	290
Other	**331**	279
Total fee and commission income	**806**	837
Fee and commission expense	**(323)**	(280)
Net fee and commission income	**483**	557

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

	2015 £m	2014 £m
Foreign exchange translation gains	**61**	48
Gains on foreign exchange trading transactions	**50**	50
Total foreign exchange	**111**	98
Investment property gains (note 23)	**7**	7
Securities and other gains (see below)	**34**	376
Net trading income	**152**	481

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:

	2015 £m	2014 £m
Net income arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**54**	579
Equity shares	**159**	91
Total net income arising on assets held at fair value through profit or loss	**213**	670
Net losses on financial instruments held for trading	**(179)**	(294)
Securities and other gains	**34**	376

8 Other operating income

	2015 £m	2014 £m
Operating lease rental income	**24**	44
Rental income from investment properties (note 23)	**5**	22
Gains on disposal of available-for-sale financial assets (note 36)	**37**	137
Share of results of joint ventures and associates	**(3)**	32
Other	**(19)**	(160)
Total other operating income	**44**	75

9 Operating expenses

	2015 £m	2014 £m
Staff costs:		
Salaries	**1,178**	1,213
Social security costs	**121**	123
Pensions and other post-retirement benefit schemes (note 30):		
Past service credits and curtailment gain[1]	**–**	(342)
Other	**214**	234
	214	(108)
Other staff costs	**20**	109
	1,533	1,337
Premises and equipment:		
Rent and rates	**155**	179
Repairs and maintenance	**14**	28
Other	**91**	112
	260	319
Other expenses:		
Communications and data processing	**164**	175
Advertising and promotion	**67**	68
Professional fees	**14**	17
Other	**819**	592
	1,064	852
Depreciation and amortisation:		
Depreciation of property, plant and equipment (note 23)	**150**	158
Amortisation of other intangible assets (note 22)	**24**	21
	174	179
Total operating expenses, excluding regulatory provisions	**3,031**	2,687
Regulatory provisions:		
Payment protection insurance provision (note 32)	**1,102**	674
Other regulatory provisions (note 32)	**319**	244
	1,421	918
Total operating expenses	**4,452**	3,605

[1]On 11 March 2014 the Group announced a change to its defined benefit pension schemes, revising the existing cap on the increases in pensionable pay used in calculating the pension benefit, from 2 per cent to nil with effect from 2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet by £342 million with a corresponding curtailment gain recognised in the income statement.

9 Operating expenses (continued)

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

	2015	2014
UK	35,982	39,738
Overseas	369	410
Total	**36,351**	40,148

Fees payable to the Company's auditors

During the year the auditors earned the following fees:

	2015 £m	2014 £m
Fees payable for the audit of the Company's current year annual report	1.1	1.0
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	2.3	2.5
Other services supplied pursuant to legislation	0.5	0.4
Total fees payable to the Company's auditors by the Group	**3.9**	3.9

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

	2015 £m	2014 £m
Reviews of the financial position of corporate and other borrowers	0.1	0.1

10 Impairment

	2015 £m	2014 £m
Impairment losses on loans and receivables:		
Loans and advances to customers	217	469
Debt securities classified as loans and receivables	(2)	2
Total impairment losses on loans and receivables (note 18)	215	471
Impairment of available-for-sale financial assets	4	4
Other credit risk provisions	(26)	17
Total impairment charged to the income statement	**193**	492

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

11 Taxation

a Analysis of tax charge for the year

	2015 £m	2014[1] £m
UK corporation tax:		
Current tax on profit for the year	**(284)**	(113)
Adjustments in respect of prior years	**(48)**	(64)
	(332)	(177)
Foreign tax:		
Current tax on profit for the year	**(16)**	(5)
Adjustments in respect of prior years	**(2)**	(3)
	(18)	(8)
Current tax charge	**(350)**	(185)
Deferred tax (note 31):		
Origination and reversal of temporary differences	**(412)**	(595)
Reduction in UK corporation tax rate and related impacts	**30**	8
Adjustments in respect of prior years	**3**	102
	(379)	(485)
Tax charge	**(729)**	(670)

[1]Restated – see note 1.

The tax charge for 2015 is based on a UK corporation tax rate of 20.25 per cent (2014: 21.5 per cent).

b Factors affecting the tax charge for the year

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

	2015 £m	2014[1] £m
Profit before tax	**2,740**	3,550
Tax charge thereon at UK corporation tax rate of 20.25 per cent (2014: 21.5 per cent)	**(555)**	(763)
Factors affecting charge:		
UK corporation tax rate change and related impacts	**30**	8
Disallowed items[2]	**(203)**	(15)
Non-taxable items	**21**	20
Overseas tax rate differences	**(5)**	(6)
Gains exempted or covered by capital losses	**31**	42
Adjustments in respect of previous years	**(47)**	35
Effect of results of joint ventures and associates	**(1)**	7
Other items	**–**	2
Tax charge on profit on ordinary activities	**(729)**	(670)

[1]Restated –see note 1.

[2]The Finance (No. 2) Act 2015 introduced restrictions on the tax deductibility of provisions for conduct charges arising on or after 8 July 2015. This has resulted in an additional income statement tax charge of £151 million.

The Finance (No. 2) Act 2015 (the Act) was substantively enacted on 26 October 2015. The Act reduced the main rate of corporation tax to 19 per cent from 1 April 2017 and 18 per cent from 1 April 2020; however, from 1 January 2016 banking profits will be subject to an additional surcharge of 8 per cent. The change in the main rate of corporation tax from 20 per cent to 18 per cent, and the additional surcharge of 8 per cent, have resulted in movement in the Group's net deferred tax asset at 31 December 2015 of £6 million, comprising the £30 million credit included in the income statement and a £24 million charge included in equity.

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

	2015 £m	2014 £m
Trading assets	**4,230**	13,750
Other financial assets at fair value through profit or loss	**1,598**	1,604
Total	**5,828**	15,354

These assets are comprised as follows:

	2015		2014	
	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	**4,230**	**–**	13,476	–
Loans and advances to banks	**–**	**–**	201	–
Debt securities:				
Government securities	**–**	**–**	45	–
Corporate and other debt securities	**–**	**1,372**	28	1,432
	–	**1,372**	73	1,432
Equity shares	**–**	**226**	–	172
Total	**4,230**	**1,598**	13,750	1,604

At 31 December 2015 £1,593 million (2014: £172 million) of trading and other financial assets at fair value through profit or loss had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase and reverse repurchase agreements see note 46.

13 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; and
- 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 46.

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 43.

The principal derivatives used by the Group are as follows:

- Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.
- Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.
- Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place.
- Equity derivatives are also used by the Group as part of its equity-based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date.

13 Derivative financial instruments (continued)

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

	2015			2014		
The 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	**2,141**	**35**	**23**	1,657	10	48
Currency swaps	**48,813**	**1,172**	**861**	63,975	1,010	729
Options purchased	**215**	**12**	**–**	227	7	–
Options written	**251**	**–**	**12**	293	–	9
	51,420	**1,219**	**896**	66,152	1,027	786
Interest rate contracts:						
Interest rate swaps	**236,948**	**8,415**	**8,567**	426,043	14,337	15,233
Forward rate agreements	**39,112**	**11**	**14**	21,759	4	4
Options purchased	**6,180**	**691**	**–**	9,911	1,047	–
Options written	**7,590**	**–**	**782**	9,695	–	721
Futures	**22,451**	**–**	**–**	56,149	1	–
	312,281	**9,117**	**9,363**	523,557	15,389	15,958
Credit derivatives	**541**	**–**	**11**	541	12	–
Equity and other contracts	**471**	**382**	**372**	642	411	385
Total derivative assets/liabilities held for trading	**364,713**	**10,718**	**10,642**	590,892	16,839	17,129
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**21,646**	**2,804**	**230**	22,789	3,591	202
Cross currency swaps	**469**	**19**	**11**	2,178	75	30
	22,115	**2,823**	**241**	24,967	3,666	232
Derivatives designated as cash flow hedges:						
Interest rate swaps	**44,922**	**1,385**	**1,861**	71,379	2,977	3,394
Cross currency swaps	**–**	**–**	**–**	759	4	13
Futures	**7,487**	**–**	**–**	25,297	–	–
	52,409	**1,385**	**1,861**	97,435	2,981	3,407
Total derivative assets/liabilities held for hedging	**74,524**	**4,208**	**2,102**	122,402	6,647	3,639
Total recognised derivative assets/liabilities	**439,237**	**14,926**	**12,744**	713,294	23,486	20,768

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in note 46 Credit risk.

13 Derivative financial instruments (continued)

Hedged cash flows

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

2015	**0-1 years £m**	**1-2 years £m**	**2-3 years £m**	**3-4 years £m**	**4-5 years £m**	**5-10 years £m**	**10-20 years £m**	**Over 20 years £m**	**Total £m**
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**60**	**54**	**106**	**121**	**144**	**672**	**174**	**18**	**1,349**
Forecast payable cash flows	**–**	**(10)**	**(36)**	**(44)**	**(45)**	**(197)**	**(210)**	**(6)**	**(548)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**73**	**64**	**109**	**126**	**147**	**643**	**170**	**17**	**1,349**
Forecast payable cash flows	**–**	**(25)**	**(40)**	**(45)**	**(46)**	**(195)**	**(193)**	**(4)**	**(548)**

2014	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	95	131	65	44	42	170	183	49	779
Forecast payable cash flows	(7)	(6)	(26)	(58)	(63)	(258)	(275)	(5)	(698)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	134	112	57	42	45	163	178	48	779
Forecast payable cash flows	(10)	(7)	(50)	(60)	(63)	(251)	(253)	(4)	(698)

There were no transactions for which cash flow hedge accounting had to be ceased in 2014 or 2015 as a result of the highly probable cash flows no longer being expected to occur.

At 31 December 2015 £13,989 million of total recognised derivative assets of the Group and £12,093 million of total recognised derivative liabilities of the Group (2014: £22,307 million of assets and £19,906 million of liabilities) had a contractual residual maturity of greater than one year.

	2015			2014		
The 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	**506**	**24**	**–**	1,261	16	–
Interest rate swaps	**50**	**5**	**–**	399	10	–
Total derivative assets/liabilities held for trading	**556**	**29**	**–**	1,660	26	–
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**2,686**	**557**	**–**	2,653	616	–
Total recognised derivative assets/liabilities, held for hedging	**2,686**	**557**	**–**	2,653	616	–
Total recognised derivative asset/liabilities	**3,242**	**586**	**–**	4,313	642	–

At 31 December 2015 £584 million of total recognised derivative assets of the Company and £nil of total recognised derivative liabilities of the Company (2014: £638 million of assets and £nil of liabilities) had a contractual residual maturity of greater than one year.

14 Loans and advances to banks of the Group

	2015 £m	2014 £m
Lending to banks	**261**	127
Money market placements with banks	**430**	619
Total loans and advances to banks	**691**	746

No allowance for impaired loans was carried against these exposures at 31 December 2014 or 31 December 2015.

At 31 December 2015 £305 million (2014: £556 million) of loans and advances to banks had a contractual residual maturity of greater than one year.

For amounts included above which are subject to reverse repurchase agreements see note 46.

15 Loans and advances to customers of the Group

	2015 £m	2014 £m
Agriculture, forestry and fishing	**596**	609
Energy and water supply	**237**	345
Manufacturing	**624**	605
Construction	**1,570**	2,132
Transport, distribution and hotels	**3,227**	4,543
Postal and telecommunications	**217**	394
Property companies	**7,107**	10,807
Financial, business and other services	**3,392**	5,922
Personal:		
Mortgages	**245,900**	241,191
Other	**10,191**	9,949
Lease financing	**546**	843
Hire purchase	**40**	16
Total loans and advances to customers before allowance for impairment losses	**273,647**	277,356
Allowance for impairment losses (note 18)	**(2,810)**	(5,683)
Total loans and advances to customers	**270,837**	271,673

At 31 December 2015 £255,034 million (2014: £255,957 million) of loans and advances to customers had a contractual residual maturity of greater than one year.

For amounts included above which are subject to reverse repurchase agreements see note 46.

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

	2015 £m	2014 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**115**	262
Later than 1 year and not later than 5 years	**270**	393
Later than 5 years	**363**	449
	748	1,104
Unearned future finance income on finance leases	**(192)**	(242)
Rentals received in advance	**(10)**	(19)
Net investment in finance leases	**546**	843

15 Loans and advances to customers of the Group (continued)

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

	2015 £m	2014 £m
Not later than 1 year	**70**	203
Later than 1 year and not later than 5 years	**206**	308
Later than 5 years	**270**	332
Net investment in finance leases	**546**	843

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 2014 and 2015 no contingent rentals in respect of finance leases were recognised in the income statement. There was no allowance for uncollectable finance lease receivables included in the allowance for impairment losses for the Group (2014: £1 million).

16 Securitisations and covered bonds

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

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

The Group's principal securitisation and covered bond programmes, together with the balances of the advances subject to these arrangements and the carrying value on the notes in issue at 31 December, are listed below. The notes in issue are reported in note 28.

	2015		2014	
	Loans and advances securitised £m	Notes in issue £m	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes				
UK residential mortgages	**26,173**	**17,963**	32,122	19,011
Credit card receivables	**7,312**	**5,277**	6,773	4,278
Dutch residential mortgages	**1,981**	**2,044**	3,871	4,010
Commercial loans	**341**	**341**	324	324
	35,807	**25,625**	43,090	27,623
Less held by the Group		**(19,208)**		(20,609)
Total securitisation programmes (note 28)		**6,417**		7,014
Covered bond programmes				
Residential mortgage-backed	**18,615**	**12,665**	22,830	15,747
Social housing loan-backed	**2,544**	**1,700**	2,826	1,800
	21,159	**14,365**	25,656	17,547
Less held by the Group		**(4,197)**		(6,339)
Total covered bond programmes (note 28)		**10,168**		11,208
Total securitisation and covered bond programmes		**16,585**		18,222

Cash deposits of £5,801 million (2014: £5,035 million) held by the Group are restricted in use to repayment of the debt securities issued by the structured entities, the term advances relating to covered bonds and other legal obligations. Additionally, the Group had certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2015 these obligations had not been triggered and the maximum exposure under these facilities was £300 million (2014: £356 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.

16 Securitisations and covered bonds (continued)

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 2015 (2014: none). Such repurchases are made in order to ensure that the expected maturity dates of the notes issued from these programmes are met.

17 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 16 for securitisations and covered bonds.

18 Allowance for impairment losses on loans and receivables of the Group

	2015			2014		
	Loans and advances to customers £m	**Debt securities £m**	**Total £m**	Loans and advances to customers £m	Debt securities £m	Total £m
Balance at 1 January	**5,683**	**143**	**5,826**	12,874	131	13,005
Exchange and other adjustments	**(214)**	**(3)**	**(217)**	(382)	10	(372)
Advances written off	**(3,517)**	**(29)**	**(3,546)**	(7,361)	–	(7,361)
Recoveries of advances written off in previous years	**622**	**4**	**626**	112	–	112
Unwinding of discount	**19**	**–**	**19**	(29)	–	(29)
Charge to the income statement (note 10)	**217**	**(2)**	**215**	469	2	471
At 31 December	**2,810**	**113**	**2,923**	5,683	143	5,826

Of the Group's total allowance in respect of loans and advances to customers, £2,061 million (2014: £4,854 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the total allowance in respect of loans and advances to customers, £1,677 million (2014: £1,769 million) was assessed on a collective basis.

19 Available-for-sale financial assets of the Group

	2015 £m	2014 £m
Debt securities:		
Government securities	**96**	131
Bank and building society certificates of deposit	**17**	15
Asset-backed securities:		
Mortgage-backed securities	**82**	499
Other asset-backed securities	**–**	343
Corporate and other debt securities	**3,984**	4,268
	4,179	5,256
Equity shares	**378**	311
Total available-for-sale financial assets	**4,557**	5,567

At 31 December 2015 £4,149 million (2014: £5,088 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 46.

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).

20 Investment in subsidiary undertakings of the Company

	2015 £m	2014 £m
At 1 January	**22,365**	22,086
Additional capital injections and transfers	**100**	279
Impairment	**(259)**	–
At 31 December	**22,206**	22,365

Details of the subsidiaries and related undertakings are given on pages 99 to 103 and are incorporated by reference.

Certain subsidiary companies currently have insufficient distributable reserves to make dividend payments, however, there were no further significant restrictions on any of the Company's subsidiaries in paying dividends or repaying loans and advances. All regulated subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

21 Goodwill

	2015 £m	2014 £m
At 1 January	**325**	334
Disposal of businesses	**–**	(9)
At 31 December	**325**	325
Cost[1]	**1,838**	1,838
Accumulated impairment losses	**(1,513)**	(1,513)
At 31 December	**325**	325

[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 £325 million (2014: £325 million), £325 million (the entire balance in 2015; the entire balance in 2014) has been allocated to retail banking activities.

The recoverable amount of goodwill carried at 31 December 2015 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 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.

22 Other intangible assets

	The Group				The Company
	Purchased credit card relationships £m	**Brands £m**	**Capitalised software enhancements £m**	**Total £m**	**Brands £m**
Cost:					
At 1 January 2014	15	24	117	156	10
Additions	–	–	26	26	–
At 31 December 2014	15	24	143	182	10
Additions	**–**	**–**	**26**	**26**	**–**
Disposals	**–**	**(14)**	**–**	**(14)**	**(10)**
At 31 December 2015	**15**	**10**	**169**	**194**	**–**
Accumulated amortisation:					
At 1 January 2014	2	24	35	61	10
Charge for the year (note 9)	3	–	18	21	–
At 31 December 2014	5	24	53	82	10
Charge for the year (note 9)	**3**	**–**	**21**	**24**	**–**
Disposals	**–**	**(14)**	**–**	**(14)**	**(10)**
At 31 December 2015	**8**	**10**	**74**	**92**	**–**
Balance sheet amount at 31 December 2015	**7**	**–**	**95**	**102**	**–**
Balance sheet amount at 31 December 2014	10	–	90	100	–

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

23 Property, plant and equipment

	Investment properties £m	Premises £m	Equipment £m	Operating lease assets £m	Total £m
Cost or valuation:					
At 1 January 2014	626	1,422	1,803	661	4,512
Exchange and other adjustments	–	1	1	(1)	1
Additions	–	35	85	–	120
Change in fair value of investment properties (note 7)	7	–	–	–	7
Disposals	(455)	(30)	(39)	(400)	(924)
At 31 December 2014	178	1,428	1,850	260	3,716
Exchange and other adjustments	**–**	**(3)**	**2**	**(2)**	**(3)**
Additions	**–**	**39**	**70**	**1**	**110**
Change in fair value of investment properties (note 7)	**7**	**–**	**–**	**–**	**7**
Disposals	**(74)**	**(49)**	**(173)**	**(3)**	**(299)**
At 31 December 2015	**111**	**1,415**	**1,749**	**256**	**3,531**
Accumulated depreciation and impairment:					
At 1 January 2014	–	844	1,350	277	2,471
Exchange and other adjustments	–	(1)	1	1	1
Depreciation charge for the year (note 9)	–	58	81	19	158
Disposals	–	(24)	(42)	(165)	(231)
At 31 December 2014	–	877	1,390	132	2,399
Exchange and other adjustments	–	**(2)**	**(2)**	**(2)**	**(6)**
Depreciation charge for the year (note 9)	–	**58**	**84**	**8**	**150**
Disposals	–	**(31)**	**(173)**	**–**	**(204)**
At 31 December 2015	–	**902**	**1,299**	**138**	**2,339**
Balance sheet amount at 31 December 2015	**111**	**513**	**450**	**118**	**1,192**
Balance sheet amount at 31 December 2014	178	551	460	128	1,317

The table above analyses movements in investment properties, all of which are categorised as level 3. See note 43 for details of levels in the fair value hierarchy.

Rental income of £5 million (2014: £22 million) and direct operating expenses arising from properties that generate rental income of £nil (2014: £5 million) have been recognised in the income statement.

There was no capital expenditure in respect of investment properties which had been contracted for but not recognised in the financial statements (2014: £nil).

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

	2015 £m	2014 £m
Receivable within 1 year	**19**	23
1 to 5 years	**17**	36
Total future minimum rentals receivable	**36**	59

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2014 and 2015 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £nil at 31 December 2015 (2014: £nil) is expected to be received under non-cancellable sub-leases of the Group's premises.

24 Other assets

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Settlement balances	**27**	7	**–**	–
Investments in joint ventures and associates	**40**	67	**–**	–
Other assets and prepayments	**466**	1,638	**–**	1
Total other assets	**533**	1,712	**–**	1

25 Deposits from banks of the Group

	2015 £m	2014 £m
Liabilities in respect of securities sold under repurchase agreements	**17**	595
Other deposits from banks	**1,524**	1,696
Total deposits from banks	**1,541**	2,291

At 31 December 2015 £1,307 million (2014: £1,463 million) of deposits from banks had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase agreements see note 46.

26 Customer deposits of the Group

	2015 £m	2014 £m
Non-interest bearing current accounts	**16,948**	15,926
Interest bearing current accounts	**24,842**	22,986
Savings and investment accounts	**132,690**	149,297
Other customer deposits	**15,566**	14,727
Total customer deposits	**190,046**	202,936

At 31 December 2015 £21,390 million (2014: £23,139 million) of customer deposits 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 46.

Notes to the accounts

27 Trading and other financial liabilities at fair value through profit or loss of the Group

	2015 £m	2014 £m
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	**4,414**	13,717
Short positions in securities	**–**	47
Total trading labilities	**4,414**	13,764
Other financial liabilities at fair value through profit or loss	**1**	5
Total trading and other financial liabilities at fair value through profit or loss	**4,415**	13,769

At 31 December 2015 £nil (2014: £6 million) of trading and other financial liabilities at fair value through profit or loss had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase agreements see note 45.

For the fair value of collateral pledged in respect of repurchase agreements see note 46.

28 Debt securities in issue of the Group

	2015 £m	2014 £m
Medium-term notes issued	**1,882**	2,074
Covered bonds (note 16)	**10,168**	11,208
Securitisation notes (note 16)	**6,417**	7,014
	18,467	20,296
Amounts due to fellow Group undertakings	**25**	112
Total debt securities in issue	**18,492**	20,408

At 31 December 2015 £15,813 million (2014: £18,120 million) of debt securities in issue had a contractual residual maturity of greater than one year.

29 Other liabilities

	The Group		The Company	
	2015 £m	2014 £m	2015 £m	2014 £m
Settlement balances	**1**	1	**–**	–
Other creditors and accruals	**1,045**	1,744	**529**	486
	1,046	1,745	**529**	486

30 Retirement benefit obligations

	The Group	
	2015 £m	2014 £m
Charge to the Group income statement		
Past service credit[1]	**–**	(342)
Other	**117**	138
Defined benefit pension schemes	**117**	(204)
Other post-retirement benefit schemes	**4**	5
Total defined benefit schemes	**121**	(199)
Defined contribution pension schemes	**93**	91
Total (credit) charge to the income statement	**214**	(108)

[1]On 11 March 2014 the Group announced a change to its defined benefit pension schemes, revising the existing cap on the increases in pensionable pay used in calculating the pension benefit, from 2 per cent to nil with effect from 2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet at 31 December 2014 by £342 million with a corresponding curtailment gain recognised in the income statement.

30 Retirement benefit obligations (continued)

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Amounts recognised in the balance sheet				
Retirement benefit assets	**675**	828	**675**	828
Retirement benefit obligations	**(188)**	(226)	**(169)**	(168)
Total amounts recognised in the balance sheet	**487**	602	**506**	660

The total amount recognised in the balance sheet relates to:

Pension schemes	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Defined benefit pension schemes	**579**	693	**598**	751
Other post-retirement benefit schemes	**(92)**	(91)	**(92)**	(91)
Total amounts recognised in the balance sheet	**487**	602	**506**	660

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 2015 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 has not provided for these deficit contributions as the future economic benefits arising from these contributions are expected to be available to the Group. The Group's overseas defined benefit pension schemes are subject to local regulatory arrangements.

The latest full valuation of the main scheme was carried out as at 30 June 2014; the results have been updated to 31 December 2015 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2015 by qualified independent actuaries.

The Group has also established a private limited company which holds assets to provide security for the Group's obligations to the HBOS Final Salary Pension Scheme. At 31 December 2015 this company held assets of approximately £2.7 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 2015.

The Group currently expects to pay contributions of approximately £160 million to its defined benefit schemes in 2016.

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

30 Retirement benefit obligations (continued)

(II) AMOUNTS IN THE FINANCIAL STATEMENTS

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Amount included in the balance sheet				
Present value of funded obligations	**(12,275)**	(12,381)	**(12,046)**	(12,120)
Fair value of scheme assets	**12,854**	13,074	**12,644**	12,871
Net amount recognised in the balance sheet	**579**	693	**598**	751

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Net amount recognised in the balance sheet				
At 1 January	**693**	(162)	**751**	(117)
Net defined benefit pension expense	**(117)**	204	**(115)**	208
Actuarial gains (losses) on defined benefit obligation	**239**	(1,507)	**218**	(1,441)
Return on plan assets	**(388)**	1,961	**(389)**	1,940
Employer contributions	**152**	193	**135**	158
Benefits paid	**–**	2	**–**	2
Exchange and other adjustments	**–**	2	**(2)**	1
At 31 December	**579**	693	**598**	751

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Movements in the defined benefit obligation				
At 1 January	**(12,381)**	(10,939)	**(12,120)**	(10,737)
Current service cost	**(127)**	(123)	**(126)**	(122)
Interest expense	**(443)**	(482)	**(438)**	(475)
Remeasurements:				
Actuarial gains – experience	**80**	72	**61**	133
Actuarial (losses) gains – demographic assumptions	**(273)**	1	**(273)**	2
Actuarial gains (losses) – financial assumptions	**432**	(1,580)	**430**	(1,576)
Benefits paid	**423**	319	**418**	314
Past service cost	**(5)**	(7)	**(5)**	(5)
Employee contributions	**(1)**	(1)	**(1)**	(1)
Curtailments	**–**	342	**–**	342
Settlements	**8**	5	**9**	5
Exchange and other adjustments	**12**	12	**(1)**	–
At 31 December	**(12,275)**	(12,381)	**(12,046)**	(12,120)

30 Retirement benefit obligations (continued)

	The Group 2015 £m	The Group 2014 £m	The Company 2015 £m	The Company 2014 £m
Changes in the fair value of scheme assets				
At 1 January	**13,074**	10,777	**12,871**	10,620
Return on plan assets excluding amounts included in interest income	**(388)**	1,961	**(389)**	1,940
Interest income	**473**	490	**469**	484
Employer contributions	**152**	193	**135**	158
Employee contributions	**1**	1	**1**	1
Benefits paid	**(423)**	(317)	**(418)**	(312)
Settlements	**(13)**	(9)	**(14)**	(9)
Administrative costs paid	**(10)**	(12)	**(10)**	(12)
Exchange and other adjustments	**(12)**	(10)	**(1)**	1
At 31 December	**12,854**	13,074	**12,644**	12,871

Composition of scheme assets:

The Group	2015 Quoted £m	2015 Unquoted £m	2015 Total £m	2014 Quoted £m	2014 Unquoted £m	2014 Total £m
Equity instruments	**612**		**612**	685	–	685
Debt instruments[1]:						
Fixed interest government bonds	**3,988**	**–**	**3,988**	3,158	–	3,158
Index-linked government bonds	**2,578**	**–**	**2,578**	2,625	–	2,625
Corporate and other debt securities	**2,868**	**–**	**2,868**	2,828	–	2,828
Asset-backed securities	**74**	–	**74**	74	–	74
	9,508	**–**	**9,508**	8,685	–	8,685
Property	**–**	**419**	**419**	–	282	282
Pooled investment vehicles	**908**	**2,341**	**3,249**	1,069	2,684	3,753
Money market instruments, derivatives, cash and other assets and liabilities	**310**	**(1,244)**	**(934)**	509	(840)	(331)
At 31 December	**11,338**	**1,516**	**12,854**	10,948	2,126	13,074

[1]Of the total debt instruments, £8,331 million (31 December 2014: £7,888 million) were investment grade (credit ratings equal to or better than 'BBB').

Company	2015 Quoted £m	2015 Unquoted £m	2015 Total £m	2014 Quoted £m	2014 Unquoted £m	2014 Total £m
Equity instruments	**576**	**–**	**576**	649	–	649
Debt instruments[1]:						
Fixed interest government bonds	**3,988**	**–**	**3,988**	3,158	–	3,158
Index-linked government bonds	**2,578**	**–**	**2,578**	2,625	–	2,625
Corporate and other debt securities	**2,858**	–	**2,858**	2,823	–	2,823
	9,424	**–**	**9,424**	8,606		8,606
Property	**–**	**414**	**414**	–	277	277
Pooled investment vehicles	**859**	**2,341**	**3,200**	1,038	2,684	3,722
Money market instruments, derivatives, cash and other assets and liabilities	**274**	**(1,244)**	**(970)**	457	(840)	(383)
At 31 December	**11,133**	**1,511**	**12,644**	10,750	2,121	12,871

[1]Of the total debt instruments, £8,331 million (31 December 2014: £7,888 million) were investment grade (credit ratings equal to or better than 'BBB').

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

30 Retirement benefit obligations (continued)

The pension schemes' pooled investment vehicles comprise:

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Equity funds	**118**	102	**118**	102
Hedge and mutual funds	**980**	1,118	**931**	1,087
Liquidity funds	**742**	1,049	**742**	1,049
Bond and debt funds	**48**	74	**48**	74
Other	**1,361**	1,410	**1,361**	1,410
At 31 December	**3,249**	3,753	**3,200**	3,722

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

	The Group	
	2015 £m	2014 £m
Current service cost	**127**	123
Net interest amount	**(30)**	(8)
Past service credits and curtailments (see below)	**–**	(342)
Settlements	**5**	4
Past service cost – plan amendments	**5**	7
Plan administration costs incurred during the year	**10**	12
Total defined benefit pension (credit) expense	**117**	(204)

Assumptions

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

	2015 %	2014 %
Discount rate	**3.87**	3.67
Rate of inflation:		
Retail Prices Index	**2.99**	2.95
Consumer Price Index	**1.99**	1.95
Rate of salary increases	**0.00**	0.00
Weighted-average rate of increase for pensions in payment	**2.58**	2.59
	2015 Years	2014 Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.7**	27.0
Women	**28.8**	29.5
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**29.1**	28.1
Women	**30.3**	30.8

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 at 31 December 2015 is assumed to live for, on average, 27.7 years for a male and 28.8 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

(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.

30 Retirement benefit obligations (continued)

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

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

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

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

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**	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Inflation (including pension increases):[1]				
Increase of 0.1 per cent	**6**	8	**127**	133
Decrease of 0.1 per cent	**(6)**	(5)	**(119)**	(122)
Discount rate:[2]				
Increase of 0.1 per cent	**(12)**	(12)	**(224)**	(299)
Decrease of 0.1 per cent	**12**	12	**230**	234
Expected life expectancy of members:				
Increase of one year	**15**	12	**324**	235
Decrease of one year	**(15)**	(10)	**(315)**	(235)

[1] At 31 December 2015, the assumed rate of RPI inflation is 2.99 per cent and CPI inflation 1.99 per cent (2014: RPI 2.95 per cent and CPI 1.95 per cent).

[2] At 31 December 2015, the assumed discount rate is 3.87 per cent (2014: 3.67 per cent).

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

The inflation assumption sensitivity applies to both the assumed rate of increase in the Consumer Prices Index (CPI) and the Retail Prices Index (RPI), and include the impact on the rate of increases to pensions, both before and after retirement. These pension increases are linked to inflation (either CPI or RPI) subject to certain minimum and maximum limits.

The sensitivity analysis (including the inflation sensitivity) does not include the impact of any change in the rate of salary increases as pensionable salaries have been frozen since 2 April 2014.

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

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

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

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

30 Retirement benefit obligations (continued)

The asset-liability matching strategy currently mitigates substantially all of the interest rate and inflation rate volatility of the liabilities.

Duration of defined benefit obligation

The weighted average duration of the defined benefit pension obligation was 21 years (31 December 2014: 21 years) for the Group and for the Company.

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 2015 the charge to the income statement in respect of defined contribution schemes was £93 million (2014: £91 million, representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2015 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 3.87 per cent (2014: 3.67 per cent).

Movements in the other post-retirement benefit obligation:

	The Group and Company	
	2015 £m	2014 £m
At 1 January	**(91)**	(79)
Actuarial gain (loss)	**2**	(10)
Insurance premiums paid	**1**	3
Charge for the year	**(4)**	(5)
At 31 December	**(92)**	(91)

31 Deferred tax

	The Group		The Company	
The movement in the net deferred tax balance is as follows:	**2015 £m**	2014[1] £m	**2015 £m**	2014 £m
Asset (liability) at 1 January	**2,226**	2,697	**(154)**	12
Exchange and other adjustments	**4**	3	**–**	(1)
Disposal of businesses	**5**	(5)	**–**	–
Income statement (charge) credit (note 11):				
Due to change in UK corporation tax rate and related impacts	**30**	8	**–**	6
Other	**(409)**	(493)	**(11)**	(75)
	(379)	(485)	**(11)**	(69)
Amount charged to equity:				
Post-retirement defined benefit scheme remeasurements	**27**	(89)	**27**	(96)
Available-for-sale financial assets (note 36)	**–**	(1)	**–**	–
Cash flow hedges (note 36)	**58**	106	**–**	–
	85	16	**27**	(96)
Asset (liability) at 31 December	**1,941**	2,226	**(138)**	(154)

[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.

31 Deferred tax (continued)

	The Group		The Company	
	2015 £m	2014[1] £m	**2015 £m**	2014 £m
Statutory position				
Deferred tax asset	**1,941**	2,226	**–**	–
Deferred tax liability	**–**	–	**(138)**	(154)
Net deferred tax asset (liability)	**1,941**	2,226	**(138)**	(154)
Tax disclosure				
Deferred tax asset	**2,142**	2,524	**–**	–
Deferred tax liability	**(201)**	(298)	**(138)**	(154)
Net deferred tax asset (liability)	**1,941**	2,226	**(138)**	(154)

[1] Restated – see note 1.

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

	2015 £m	2014[1] £m
Accelerated capital allowances	**115**	103
Pensions and other post-retirement benefits	**(1)**	(64)
Tax losses carried forward	**(554)**	(571)
Allowances for impairment losses	**12**	(13)
Other temporary differences	**49**	60
Deferred tax charge in the income statement	**(379)**	(485)

[1] Restated – see note 1.

Deferred tax assets and liabilities are comprised as follows:

	The Group		The Company	
	2015 £m	2014[1] £m	**2015 £m**	2014 £m
Deferred tax assets:				
Capital allowance	**261**	142	**–**	–
Tax losses carried forward	**1,661**	2,212	**–**	–
Other temporary differences	**220**	170	**–**	–
Total deferred tax assets	**2,142**	2,524	**–**	–

[1] Restated – see note 1.

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Deferred tax liabilities:				
Pensions and other post-retirement benefits	**(92)**	(121)	**(138)**	(154)
Allowances for impairment losses	**–**	(12)	**–**	–
Available-for-sale asset revaluation	**(9)**	(7)	**–**	–
Derivatives	**(50)**	(109)	**–**	–
Effective interest rate	**–**	(9)	**–**	–
Other temporary differences	**(50)**	(40)	**–**	–
Total deferred tax liabilities	**(201)**	(298)	**(138)**	(154)

The Finance (No. 2) Act 2015 (the Act) was substantively enacted on 26 October 2015. The Act reduced the main rate of corporation tax to 19 per cent from 1 April 2017 and 18 per cent from 1 April 2020.

In addition, the Government announced that from 1 January 2016 banking profits will be subject to surcharge of 8 per cent.

31 Deferred tax (continued)

The change in the main rate of corporation tax from 20 per cent to 18 per cent, and the additional surcharge of 8 per cent, have resulted in a movement in the Group's net deferred tax asset at 31 December 2015 of £6 million, comprising the £30 million credit included in the income statement and a £24 million charge included in equity.

Deferred tax assets
Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable. Group companies have recognised a deferred tax asset of £1,661 million for the Group and £nil for the Company (2014: £2,212 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 £93 million for the Group and £nil for the Company (2014: £185 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 £68 million for the Group and £nil for the Company (2014: £49 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 2015 of £39 million for the Group and £nil for the Company (2014: £39 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.

32 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 2015	74	918	322	232	1,546
Exchange and other adjustments	1	–	–	45	46
Provisions applied	(23)	(810)	(193)	(81)	(1,107)
(Release) charge for the year	(26)	1,102	319	19	1,414
At 31 December 2015	26	1,210	448	215	1,899

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

Payment protection insurance
The Group increased the provision for PPI costs by a further £1,102 million in 2015, bringing the total amount provided to £4,521 million. This included an additional £761 million in the second half, largely to reflect the impact of our interpretation of the proposals contained within the Financial Conduct Authority's (FCA) consultation paper regarding a potential time bar and the Plevin case.

Total costs incurred in 2015 were £810 million and as at 31 December 2015, £1,210 million or 27 per cent of the total provision, remained unutilised.

The Group has completed its Past Business Review (PBR) where it has been identified that there was a risk of potential mis-sale for certain customers, albeit monitoring continues. In addition the Group continues to progress the re-review of previously handled cases and expects this to be substantially complete by the end of the first quarter of 2016.

On 26 November 2015 the FCA published a consultation paper (CP15/39: Rules and guidance on payment protection insurance complaints) proposing a time bar and rules and guidance in light of the Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61 (Plevin).

Based on recent trends, and in light of the proposals from the FCA if implemented, the Group now expects to receive a higher level of complaints than previously assumed.

In addition, the provision includes an estimate to cover redress that would be payable under the FCA's proposed new rules and guidance in light of Plevin.

The total amount provided for PPI represents the Group's best estimate of the likely future cost. However a number of risks and uncertainties remain, in particular with respect to future volumes, the significant uncertainty around the impact of the proposed FCA media campaign, and claims management company (CMC) and customer activity in the lead up to the proposed time bar. The cost could therefore 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[1]:

- the number of customer initiated complaints received: an increase of 50,000 from the level assumed would increase the provision by £105 million;
- average uphold rate per policy: an increase of one percentage point in this assumption would increase the provision by £18 million;
- average redress paid per upheld policy: an increase of £100 in this assumption would increase the provision by £65 million.

[1]All sensitivities are influenced by a proportion of complaints falling under the Plevin rules and guidance.

32 Other provisions (continued)

Other regulatory provisions

Interest rate hedging products

In June 2012, a number of banks, including the Lloyds Banking Group, reached agreement with the FSA (now FCA) to carry out a review of sales made since 1 December 2001 of interest rate hedging products (IRHP) to certain small and medium-sized businesses. As at 31 December 2015 the Lloyds Banking Group had identified 1,735 sales of IRHPs to customers within scope of the agreement with the FCA which have opted in and are being reviewed and, where appropriate, redressed. The Lloyds Banking Group agreed that it would provide redress to any in-scope customers where appropriate. The Lloyds Banking Group continues to review the remaining cases within the scope of the agreement with the FCA and has met all of the regulator's requirements to date.

During 2015, the Lloyds Banking Group has charged a further £12 million in respect of redress and related administration costs, increasing the total amount provided for redress and related administration costs for in-scope customers to £216 million (31 December 2014: £204 million). As at 31 December 2015, the Group has utilised £200 million (31 December 2014: £98 million), with £16 million (31 December 2014: £106 million) of the provision remaining.

FCA review of complaint handling

On 5 June 2015 the FCA announced a settlement with the Lloyds Banking Group totalling £117 million, of which £42 million was borne by the Group, following its investigation into aspects of the Lloyds Banking Group's PPI complaint handling process during the period March 2012 to May 2013. The FCA did not find that the Lloyds Banking Group acted deliberately. The Lloyds Banking Group has reviewed all customer complaints fully defended during the Relevant Period. The remediation costs of reviewing these affected cases are not materially in excess of existing provisions.

Other legal actions and regulatory matters

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Lloyds Banking Group also receives complaints and claims from customers in connection with its past conduct and, where significant, provisions are held against the costs expected to be incurred as a result of the conclusions reached. During 2015, the Group charged an additional £265 million (2014: £126 million), including £50 million (2014: £nil) in response to complaints concerning packaged bank accounts.

At 31 December 2015, provisions for other legal actions and regulatory matters of £432 million (31 December 2014: £215 million) remained unutilised. The ultimate financial effect, which could be different from the current provision, of these matters will only be known once they have been resolved, the timing of which is uncertain.

Vacant leasehold property 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 four years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Provisions are made for staff and other costs related to Group restructuring initiatives at the point at which the Group becomes irrevocably committed to the expenditure.

33 Subordinated liabilities

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

The Group	Preference shares[1] £m	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2014	–	3,178	611	7,189	10,978
Repurchases and redemptions during the year:					
6.071% Non-cumulative Perpetual Preferred Securities		(439)	–	–	(439)
4.875% Undated Subordinated Fixed to Floating Rate Instruments	–	–	(78)	–	(78)
Floating Rate Undated Subordinated Notes	–	–	(50)	–	(50)
11% Subordinated Bonds 2014	–	–	–	(250)	(250)
6.75% Subordinated Callable Fixed to Floating Rate Instruments 2017	–	–	–	(9)	(9)
Subordinated Callable Floating Rate Instruments 2017	–	–	–	(36)	(36)
4.375% Callable Fixed to Floating Rate Subordinated Note 2019	–	–	–	(591)	(591)
	–	(439)	(128)	(886)	(1,453)
Exchange and other adjustments	–	153	(1)	106	258
At 31 December 2014	–	2,892	482	6,409	9,783
Repurchases and redemptions during the year:					
4.875% Subordinated Notes 2015	**–**	**–**	**–**	**(723)**	**(723)**
8.117% Non-cumulative Perpetual Preferred Securities (Class A)	**–**	**(250)**	**–**	**–**	**(250)**
6.05% Fixed to Floating Rate Undated Subordinated Notes	**–**	**–**	**(18)**	**–**	**(18)**
5.125% Undated Subordinated Fixed to Floating Rate Notes	**–**	**–**	**(50)**	**–**	**(50)**
5.109% Callable Fixed to Floating Rate Notes 2017	**–**	**–**	**–**	**(14)**	**(14)**
6.305% Subordinated Callable Fixed to Floating Notes 2017	**–**	**–**	**–**	**(35)**	**(35)**
Floating Rate Undated Subordinated Step-up Notes	**–**	**–**	**(29)**	**–**	**(29)**
6% Subordinated Notes 2033	**–**	**–**	**–**	**(191)**	**(191)**
	–	**(250)**	**(97)**	**(963)**	**(1,310)**
Exchange and other adjustments	**–**	**(3)**	**(5)**	**(161)**	**(169)**
At 31 December 2015	**–**	**2,639**	**380**	**5,285**	**8,304**

[1]Since 2009, the Company has had in issue 100 6% non-cumulative preference shares of £1 each and the Company's subsidiary, Bank of Scotland plc, has had in issue 400 6% non-cumulative preference shares of 25p each.

33 Subordinated liabilities (continued)

The Company	Preference shares[1] £m	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2014	–	–	1,969	6,272	8,241
Repurchases and redemptions during the year:					
6.071% Undated Subordinated Fixed to Floating Rate Instruments (US$750 million)	–	–	(439)	–	(439)
4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)	–	–	(78)	–	(78)
Floating Rate Undated Subordinated Notes (€500 million)	–	–	(50)	–	(50)
Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)	–	–	–	(36)	(36)
6.75% Subordinated Callable Fixed to Floating Rate Instruments 2017 (Aus$200 million)	–	–	–	(9)	(9)
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)	–	–	–	(591)	(591)
	–	–	(567)	(636)	(1,203)
Exchange and other adjustments	–	95	6	(28)	73
At 31 December 2014	–	95	1,408	5,608	7,111
Repurchases and redemptions during the year:					
4.875% Subordinated Notes 2015	**–**	**–**	**–**	**(723)**	**(723)**
6.05% Fixed to Floating Rate Undated Subordinated Notes	**–**	**–**	**(18)**	**–**	**(18)**
5.125% Undated Subordinated Fixed to Floating Rate Notes	**–**	**–**	**(50)**	**–**	**(50)**
5.109% Callable Fixed to Floating Rate Notes 2017	**–**	**–**	**–**	**(14)**	**(14)**
6.305% Subordinated Callable Fixed to Floating Notes 2017	**–**	**–**	**–**	**(35)**	**(35)**
Floating Rate Undated Subordinated Step-up Notes	**–**	**–**	**(29)**	**–**	**(29)**
6% Subordinated Notes 2033	**–**	**–**	**–**	**(194)**	**(194)**
	–	**–**	**(97)**	**(966)**	**(1,063)**
Exchange and other adjustments	**–**	**(8)**	**24**	**(106)**	**(90)**
At 31 December 2015	**–**	**87**	**1,335**	**4,536**	**5,958**

[1]Since 2009, the Company has had in issue 100 6% non-cumulative preference shares of £1 each.

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 (2014: none). No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the Prudential Regulation Authority.

34 Share capital

(1) Authorised share capital

	Group and Company			
	2015 Number of shares	2014 Number of shares	**2015 £m**	2014 £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			
	2015 Number of shares	2014 Number of shares	**2015 £m**	2014 £m
Issued and fully paid ordinary shares				
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

Share capital and control

There are no restrictions on the transfer of shares in the Company other than as set out in the articles of association, and certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws).

Ordinary shares
The holders of ordinary shares, who held 100 per cent of the total ordinary share capital at 31 December 2015, are entitled to receive the Company's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares may also receive a dividend (subject to the provisions of the Company's articles of association) and on a winding up may share in the assets of the Company.

35 Share premium account

	Group and Company	
	2015 £m	2014 £m
At 1 January	**18,655**	18,655
Capital restructuring	**(18,655)**	–
At 31 December	**–**	18,655

During 2015 the Company reduced its share premium account by Special Resolution which was confirmed by an order of the Court of Session, Scotland on 11 June 2015. The balance on the share premium account of £18,655 million has been transferred to retained profits.

36 Other reserves

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Other reserves comprise:				
Merger and other reserves[1]	**10,051**	10,051	**9,537**	9,537
Capital redemption reserve[1]	**141**	141	**141**	141
Revaluation reserve in respect of available-for-sale financial assets	**145**	158	**–**	–
Cash flow hedging reserve	**169**	484	**–**	–
Foreign currency translation reserve	**(27)**	(97)	**–**	15
At 31 December	**10,479**	10,737	**9,678**	9,693

[1]There were no movements in these reserves in 2014 or 2015.

Movements in other reserves were as follows:

	The Group	
	2015 £m	2014 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	**158**	38
Change in fair value of available-for-sale financial assets	**(16)**	250
Deferred tax	**–**	(49)
Current tax	**2**	–
	(14)	201
Income statement transfers:		
Disposals (note 8)	**(37)**	(137)
Deferred tax	**–**	51
	(37)	(86)
Impairment	**38**	8
Deferred tax	**–**	(3)
	38	5
At 31 December	**145**	158

36 Other reserves (continued)

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Cash flow hedging reserve				
At 1 January	**484**	907	**–**	–
Change in fair value of hedging derivatives	**181**	(55)	**–**	–
Deferred tax	**(54)**	11	**–**	–
	127	(44)	**–**	–
Income statement transfers	**(554)**	(474)	**–**	–
Deferred tax	**112**	95	**–**	–
	(442)	(379)	**–**	–
At 31 December	**169**	484	**–**	–

	The Group		The Company	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Foreign currency translation reserve				
At 1 January	**(97)**	(98)	**15**	15
Currency translation differences arising in the year	**63**	1	**(15)**	–
Foreign currency gains on net investment hedges (tax: £nil)	**7**	–	**–**	–
At 31 December	**(27)**	(97)	**–**	15

37 Retained profits

	The Group		The Company	
	2015 £m	2014[1] £m	**2015 £m**	2014 £m
At 1 January	**(9,437)**	(11,308)	**(7,520)**	(6,720)
Profit for the year[2]	**2,011**	2,880	**9,398**	31
Capital restructuring	**18,655**	–	**18,655**	–
Dividends paid (note 39)	**(11,500)**	(1,500)	**(11,500)**	(1,500)
Capital contribution received	**89**	136	**101**	279
Post-retirement defined benefit scheme remeasurement	**(116)**	355	**(142)**	390
At 31 December	**(298)**	(9,437)	**8,992**	(7,520)

[1]Restated – see note 1.

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

38 Other equity instruments

	Group	
	2015 £m	2014 £m
At 1 January	**–**	–
Additional Tier 1 securities issued in the year	**1,500**	–
At 31 December	**1,500**	–

On 4 December 2015 the Group's subsidiary Bank of Scotland plc issued £1,500,000,000 of Additional Tier 1 (AT1) securities to Lloyds Bank plc. The AT1 securities are Fixed Rate Resetting Perpetual Subordinated Permanent Write-Down Securities with no fixed maturity or redemption date.

The principal terms of the AT1 securities are described below:

- The securities rank behind the claims against Bank of Scotland plc of unsubordinated creditors on a Winding-Up.
- The securities bear a fixed rate of interest until the first call date. After the initial call date, in the event that they are not redeemed, the AT1 securities will bear interest at rates fixed periodically in advance for five year periods based on the then prevailing 5-year mid-swap rate plus initial spread.
- Interest on the securities will be due and payable only at the sole discretion of Bank of Scotland plc and Bank of Scotland plc may at any time elect to cancel any Interest Payment (or any part thereof) which would otherwise be payable on any Interest Payment Date. There are also certain restrictions on the payment of interest as specified in the terms.
- The securities are undated and are repayable, at the option of Bank of Scotland plc, in whole at the first call date, or at any Interest Payment date thereafter. In addition, the AT1 securities are repayable, at the option of Bank of Scotland plc, in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the PRA.
- The securities will be subject to a Permanent Write Down should the fully loaded Common Equity Tier 1 ratio of Bank of Scotland plc fall below 7.0 per cent.

39 Dividends

Dividends paid in the year were as follows:

	2015 £m	2014 £m
Final dividend for previous year paid during the current year	**–**	–
Interim dividends	**11,500**	1,500
	11,500	1,500

40 Share-based payments

During the year ended 31 December 2015 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 9), was £144 million (2014: £136 million).

Deferred bonus plans
The Lloyds Banking Group operates a number of deferred bonus plans that are equity settled. Bonuses in respect of employee performance in 2015 have been recognised in the charge in line with the proportion of the deferral period completed.

Save-As-You-Earn schemes
Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £500 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Lloyds Banking Group at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

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

	2015 Number of options	**2015** Weighted average exercise price (pence)	2014 Number of options	2014 Weighted average exercise price (pence)
Outstanding at 1 January	**783,626,383**	**48.73**	500,969,617	41.16
Granted	**156,797,949**	**60.70**	326,565,564	60.02
Exercised	**(32,683,177)**	**41.83**	(7,287,899)	41.29
Forfeited	**(27,740,207)**	**48.69**	(18,949,167)	41.68
Cancelled	**(24,943,674)**	**56.04**	(15,561,144)	54.04
Expired	**(4,911,054)**	**48.34**	(2,110,588)	48.15
Outstanding at 31 December	**850,146,220**	**50.99**	783,626,383	48.73
Exercisable at 31 December	**533,654**	**180.66**	1,852	180.66

The weighted average share price at the time that the options were exercised during 2015 was £0.77 (2014: £0.77). The weighted average remaining contractual life of options outstanding at the end of the year was 1.9 years (2014: 2.6 years).

The weighted average fair value of SAYE options granted during 2015 was £0.17 (2014: £0.22). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

For the HBOS sharesave plan, no options were exercised during 2015 or 2014. The options outstanding at 31 December 2015 had an exercise price of £1.8066 (2014: £1.8066) and a weighted average remaining contractual life of 0.4 years (2014: 1.4 years).

Other share option plans
Lloyds Banking Group Executive Share Plan 2003
The Plan was adopted in December 2003 and under the Plan share options may be granted to senior employees. Options under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions. The Plan is used not only to compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes with, in some instances, the grant being made subject to individual performance conditions.

For options granted on 27 March 2014 under the Commercial Banking Transformation Plan (CBTP), the number of options that may be delivered in March 2017 may vary by a factor of 0-4 from the original 'on-target' award, depending on the degree to which the performance conditions have been met. An 'on-target' vesting is contingent upon Commercial Banking achieving £2.5 billion underlying profit and 2 per cent Return on Risk-weighted Assets ('RoRWA') on 31 December 2016. The Plan will pay out at between £1.9 billion and £3 billion underlying profit, and between 1.6 per cent and 2.5 per cent RoRWA.

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

	2015 Number of options	**2015** Weighted average exercise price (pence)	2014 Number of options	2014 Weighted average exercise price (pence)
Outstanding at 1 January	**233,389,084**	**Nil**	37,354,979	Nil
Granted	**9,813,363**	**Nil**	225,424,109	Nil
Exercised	**(13,313,421)**	**Nil**	(21,870,649)	Nil
Forfeited	**(8,374,250)**	**Nil**	(7,114,199)	Nil
Lapsed	**(117,179)**	**Nil**	(405,156)	Nil
Outstanding at 31 December	**221,397,597**	**Nil**	233,389,084	Nil
Exercisable at 31 December	**3,972,911**	**Nil**	9,068,802	Nil

The weighted average fair value of options granted in the year was £0.75 (2014: £0.72). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2015 was £0.83 (2014: £0.75). The weighted average remaining contractual life of options outstanding at the end of the year was 6.1 years (2014: 7.0 years).

40 Share-based payments (continued)

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 Lloyds Banking Group over a three year period. Awards are made within limits set by the rules of the Plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

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.

At the end of the performance period for the 2012 grant, the targets had not been fully met and therefore these awards vested in 2015 at a rate of 96.6 per cent.

	2015 Number of shares	2014 Number of shares
Outstanding at 1 January	**522,836,111**	548,885,895
Granted	**121,676,131**	120,952,253
Vested	**(196,193,904)**	(73,516,122)
Forfeited	**(50,251,592)**	(73,485,915)
Outstanding at 31 December	**398,066,746**	522,836,111

Awards in respect of the 2013 grant will vest in 2016 at a rate of 94.18 per cent.

The fair value calculations at 31 December 2015 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Save-As-You-Earn	**Executive Share Plan 2003**	**LTIP**	**Commercial Banking Transformation Program**
Weighted average risk-free interest rate	**0.76%**	**0.56%**	**0.85%**	**0.68%**
Weighted average expected life	**3.3 years**	**1.4 years**	**3.0 years**	**1.7 years**
Weighted average expected volatility	**24%**	**21%**	**28%**	**20%**
Weighted average expected dividend yield	**2.5%**	**2.5%**	**2.5%**	**2.5%**
Weighted average share price	**£0.76**	**£0.80**	**£0.80**	**£0.78**
Weighted average exercise price	**£0.61**	**nil**	**nil**	**nil**

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

Matching shares

The Lloyds Banking Group undertakes to match shares purchased by employees up to the value of £45 per month; these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

The number of shares awarded relating to matching shares in 2015 was 18,001,413 (2014: 16,248,562), with an average fair value of £0.78 (2014: £0.78), based on market prices at the date of award.

Fixed share awards

Fixed share awards were introduced in 2014 in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for certain Lloyds Banking Group employees, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The fixed share awards are delivered in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award. The number of shares purchased in 2015 was 8,237,469 (2014: 7,761,624).

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

41 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 2015, 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.

	2015 £m	2014 £m
Compensation		
Salaries and other short-term benefits	**7**	8
Post-employment benefits	**–**	1
Share-based payments	**9**	9
Total compensation	**16**	18

The aggregate of the emoluments of the directors was £5.5 million (2014: £6.1 million).

Aggregate company contributions in respect of key management personnel to defined contribution pension schemes were £0.1 million (2014: 0.1 million).

The total for the highest paid director (António Horta-Osório) was £2,581,000, (2014: (António Horta-Osório) £2,391,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in either year.

	2015 million	2014 million
Share options over Lloyds Banking Group plc shares		
At 1 January	**13**	14
Granted (includes entitlement of appointed key management personnel)	**3**	–
Exercised/lapsed (includes entitlements of former key management personnel)	**(7)**	(1)
At 31 December	**9**	13

	2015 million	2014 million
Share incentive plans settled in Lloyds Banking Group plc shares		
At 1 January	**102**	105
Granted (includes entitlements of appointed key management personnel)	**37**	19
Exercised/lapsed (includes entitlements of former key management personnel)	**(57)**	(22)
At 31 December	**82**	102

41 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:

	2015 £m	2014 £m
Loans		
At 1 January	**3**	2
Advanced (includes loans of appointed key management personnel)	**4**	2
Repayments (includes loans of former key management personnel)	**(2)**	(1)
At 31 December	**5**	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 3.99 per cent and 23.95 per cent in 2015 (2014: 0.5 per cent and 23.95 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2014: £nil).

	2015 £m	2014 £m
Deposits		
At 1 January	**16**	13
Placed (includes deposits of appointed key management personnel)	**58**	32
Withdrawn (includes deposits of former key management personnel)	**(61)**	(29)
At 31 December	**13**	16

Deposits placed by key management personnel attracted interest rates of up to 4.7 per cent in 2015 (2014: 4.7 per cent).

At 31 December 2015, the Group did not provide any guarantees in respect of key management personnel (2014: none).

At 31 December 2015, 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 four directors and six connected persons. (2014: £1 million with six directors and six 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:

	2015 £m	2014 £m
Assets, included within:		
Amounts owed by Group entities	**14,105**	16,313
Derivative financial instruments	**586**	–
	14,691	16,313
Liabilities, included within:		
Amounts owed to Group entities	**7,819**	7,040
Subordinated liabilities	**1,867**	–
	9,686	7,040

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 2015 the Company earned interest income on the above asset balances of £467 million (2014: £525 million) and incurred interest expense on the above liability balances of £205 million (2014: £266 million).

41 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:

	The Group		The Company	
	2015 £m	2014[1] £m	**2015 £m**	2014 £m
Assets included within:				
Derivative financial instruments	**9,206**	14,866	**–**	–
Loans and receivables	**31,560**	48,737	**605**	1,346
Trading and other financial assets at fair value through profit or loss	**5,602**	–	**1,371**	1,431
Other	**–**	–	**–**	–
	46,368	63,603	**1,976**	2,777
Liabilities included within:				
Deposits from banks and customers	**80,047**	78,647	**2,467**	2,695
Derivative financial instruments	**9,507**	12,911	**–**	–
Subordinated liabilities	**465**	291	**19**	25
Trading financial assets	**4,112**	–	**–**	–
Other liabilities	**598**	665	**–**	–
	94,729	92,514	**2,486**	2,720

[1]Restated – see note 1.

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 2015 the Group earned £382 million and the Company earned £25 million of interest income on the above asset balances (2014: Group: £604 million; Company: £43 million); the Group incurred £1,820 million and the Company incurred £71 million of interest expense on the above liability balances (2014: Group: £1,886 million; Company: £155 million).

During the year, certain subsidiaries and fellow Lloyds Banking Group undertakings incurred expenditure for the benefit of the Group's subsidiary, Bank of Scotland plc, which has not been recharged to Bank of Scotland plc; and Bank of Scotland plc incurred expenditure for the benefit of certain Group subsidiaries and fellow Lloyds Banking Group undertakings, which has not been recharged to those entities.

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. As at 31 December 2015, HM Treasury held an interest of 9.14 per cent in Lloyds Banking Group plc's ordinary share capital, with its interest having fallen below 20 per cent on 11 May 2015. As a consequence of HM Treasury no longer being considered to have a significant influence, it ceased to be a related party of the Company for IAS 24 purposes at that date.

In accordance with IAS 24, UK Government-controlled entities were related parties of the Group until 11 May 2015. The Group regarded the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc (RBS), Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

During the year ended 31 December 2015, 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 participates in the UK government's National Loan Guarantee Scheme, providing eligible UK businesses with discounted funding 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 pre-agreed period of time.

Funding for Lending
The Funding for Lending Scheme represents a further source of cost effective secured term funding available to the Lloyds Banking Group. The initiative supports a broad range of UK based customers, focusing primarily on providing small businesses with cheaper finance to invest and grow. In November 2015, the Bank of England announced that the deadline for banks to draw down their borrowing allowance would be extended for a further two years until 31 January 2018. At 31 December 2015, the Lloyds Banking Group had drawn down £32 billion (31 December 2014: £20 billion) under the Scheme.

Enterprise Finance Guarantee Scheme
The Lloyds Banking Group participates in the Enterprise Finance Guarantee Scheme which supports viable businesses with access to lending where they would otherwise be refused a loan due to a lack of lending security. The Department for Business, Innovation and Skills provides the lender with a guarantee of up to 75 per cent of the capital of each loan subject to the eligibility of the customer. As at 31 December 2015, the Lloyds Banking Group had offered 6,509 loans to customers, worth over £550 million. Under the most recent renewal of the terms of the scheme, Lloyds Bank plc and Bank of Scotland plc, on behalf of the Lloyds Banking Group, contracted with The Secretary of State for Business, Innovation and Skills.

Help to Buy
The Help to Buy Scheme is a scheme promoted by the UK government and is aimed to encourage participating lenders to make mortgage loans available to customers who require higher loan-to-value mortgages. Halifax and Lloyds are currently participating in the Scheme whereby customers borrow between 90 per cent and 95 per cent of the purchase price. In return for the payment of a commercial fee, HM Treasury has agreed to provide a guarantee to the lender to cover a proportion of any loss made by the lender. £3,133 million of outstanding loans at 31 December 2015 (31 December 2014: £1,950 million) had been advanced under this scheme.

41 Related party transactions (continued)

Business Growth Fund
The Lloyds Banking Group has invested £176 million (31 December 2014: £118 million) in the Business Growth Fund (under which an agreement was entered into with RBS amongst others) and, as at 31 December 2015, carries the investment at a fair value of £170 million (31 December 2014: £105 million).

Big Society Capital
The Lloyds Banking Group has invested £36 million (31 December 2014: £31 million) in the Big Society Capital Fund under which an agreement was entered into with RBS amongst others.

Housing Growth Partnership
The Lloyds Banking Group has committed to invest up to £50 million into the Housing Growth Partnership under which an agreement was entered into with the Homes and Communities Agency.

Central bank facilities
In the ordinary course of business, the 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
Pension funds
At 31 December 2015 there were customer deposits of £24 million (2014: £20 million) and insurance and investment contract liabilities of £4 million (2014: £8 million) related to the Group's pension arrangements.

Joint ventures and associates
At 31 December 2015 there were loans and advances to customers of £225 million (2014: £1,901 million) outstanding and balances within customer deposits of £8 million (2014: £24 million) relating to joint ventures and associates.

In addition to the above balances, the Group has a number of other associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2015, these companies had total assets of approximately £54 million (2014: £1,647 million), total liabilities of approximately £103 million (2014: £1,997 million) and for the year ended 31 December 2015 had turnover of approximately £114 million (2014: £1,503 million) and made a net loss of approximately £3 million (2014: net loss of £175 million). In addition, the Group has provided £15 million (2014: £918 million) of financing to these companies on which it received approximately £1 million (2014: £35 million) of interest income in the year.

42 Contingent liabilities and commitments

Interchange fees
With respect to multi-lateral interchange fees (MIFs), the Lloyds Banking Group is not directly involved in the on-going investigations and litigation (as described below) which involve card schemes such as Visa and MasterCard. However, the Lloyds Banking Group is a member of Visa and MasterCard and other card schemes.

- The European Commission continues to pursue certain competition investigations into MasterCard and Visa probing, amongst other things, MIFs paid in respect of cards issued outside the EEA;
- Litigation continues in the English Courts against both Visa and MasterCard. This litigation has been brought by several retailers who are seeking damages for allegedly 'overpaid' MIFs. From publicly available information, it is understood these damages claims are running to different timescales with respect to the litigation process, and their outcome remains uncertain. It is also possible that new claims may be issued.

On 2 November 2015, Visa Inc announced its proposed acquisition of Visa Europe, which remains subject to completion. As set out in the announcement by the Lloyds Banking Group on 2 November, the Lloyds Banking Group's share of the sale proceeds will comprise upfront consideration of cash (the amount of which remains subject to adjustment prior to completion) and preferred stock. The preferred stock will be convertible into Class A Common Stock of Visa Inc or its equivalent upon occurrence of certain events. As part of this transaction, the Lloyds Banking Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies how liabilities will be allocated between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. Visa Inc may only have recourse to the LSA once €1 billion of damages have been applied to the value of the UK preferred stock received by Visa UK members (including the Lloyds Banking Group) as part of the consideration to the transaction. The value of the preferred stock will be reduced (by making a downward adjustment to the conversion rate) in an amount equal to any covered losses. The maximum amount of liability to which the Lloyds Banking Group may be subject under the LSA is capped at the cash consideration to be received by the Lloyds Banking Group. Visa Inc may also have recourse to a general indemnity, currently in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

The ultimate impact on the Lloyds Banking Group of the above investigations and the litigation against Visa and MasterCard cannot be known before the conclusion of these matters.

LIBOR and other trading rates
In July 2014, the Lloyds Banking Lloyds Banking Group announced that it had reached settlements totalling £217 million (at 30 June 2014 exchange rates) to resolve with UK and US federal authorities legacy issues regarding the manipulation several years ago of Lloyds Banking Group companies' submissions to the British Bankers' Association (BBA) London Interbank Offered Rate (LIBOR) and Sterling Repo Rate. The Lloyds Banking Group continues to cooperate with various other government and regulatory authorities, including the Serious Fraud Office, the Swiss Competition Commission, and a number of US State Attorneys General, in conjunction with their investigations into submissions made by panel members to the bodies that set LIBOR and various other interbank offered rates.

42 Contingent liabilities and commitments (continued)

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, Japanese Yen and Sterling LIBOR. The lawsuits, which contain broadly similar allegations, allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act and the Commodity Exchange Act, as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims, including those asserted under US anti-trust laws, have been dismissed by the US Federal Court for Southern District of New York (the District Court). That court's dismissal of plaintiffs' anti-trust claims has been appealed to the New York Federal Court of Appeal. The OTC and Exchange – Based plaintiffs' claims were dismissed in November 2015 for lack of personal jurisdiction against the Lloyds Banking Group.

Certain Lloyds Banking Group companies are also named as defendants in UK based claims raising LIBOR manipulation allegations in connection with interest rate hedging products.

It is currently not possible to predict the scope and ultimate outcome on the Lloyds Banking Group of the various outstanding regulatory investigations not encompassed by the settlements, any private lawsuits or any related challenges to the interpretation or validity of any of the Lloyds Banking Group's contractual arrangements, including their timing and scale.

UK shareholder litigation
In August 2014, the Lloyds Banking Group and a number of former directors were named as defendants in a claim filed in the English High Court by a number of claimants who held shares in Lloyds TSB Lloyds Banking Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of fiduciary and tortious duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. It is currently not possible to determine the ultimate impact on the Lloyds Banking Group (if any), but the Lloyds Banking Group intends to defend the claim vigorously.

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

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. At 31 March 2015, the end of the latest FSCS scheme year, the principal balance outstanding on these loans was £15,797 million (31 March 2014: £16,591 million). Although the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. The amount of future levies payable by the Lloyds Banking Group depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Lloyds Banking Group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit-taking participants.

Tax authorities
The Lloyds Banking Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities including open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law. The Lloyds Banking Group has an open matter in relation to a claim for Lloyds Banking Group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Lloyds Banking Group that 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 £350 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. There are a number of other open matters on which the Lloyds Banking Group is in discussion with HMRC; none of these is expected to have a material impact on the financial position of the Group.

Residential mortgage repossessions
In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases, concerning certain aspects of the Lloyds Banking Group's practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA has indicated that it will issue a Consultation Paper in relation to industry practice in this area in February 2016. The Lloyds Banking Group will respond as appropriate to this and any investigations, proceedings, or regulatory action that may in due course be instigated as a result of these issues.

The Financial Conduct Authority's announcement on time-barring for PPI complaints and Plevin v Paragon Personal Finance Limited
On 26 November 2015 the FCA issued a Consultation Paper on the introduction of a deadline by which consumers would need to make their PPI complaints or else lose their right to have them assessed by firms or the Financial Ombudsman Service, and proposed rules and guidance concerning the handling of PPI complaints in light of the Supreme Court's decision in *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61 (*Plevin*). The Financial Ombudsman Service is also considering the implications of *Plevin* for PPI complaints. The implications of potential time-barring and the *Plevin* decision in terms of the scope of any court proceedings or regulatory action remain uncertain.

Other legal actions and regulatory matters
In addition, during the ordinary course of business the Lloyds Banking Group is subject to other complaints and threatened or actual legal proceedings (including class or Lloyds Banking Group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the 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 made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. However the 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.

42 Contingent liabilities and commitments (continued)

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.

	The Group	
	2015 £m	2014 £m
Contingent liabilities		
Acceptances and endorsements	**–**	1
Other:		
Other items serving as direct credit substitutes	**15**	8
Performance bonds and other transaction-related contingencies	**90**	220
	105	228
Total contingent liabilities	**105**	229

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.

	The Group	
	2015 £m	2014 £m
Commitments		
Documentary credits and other short-term trade-related transactions	**–**	1
Forward asset purchases and forward deposits placed	**23**	–
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**9,092**	7,515
Other commitments	**21,099**	21,047
	30,191	28,562
1 year or over original maturity	**3,992**	3,853
Total commitments	**34,206**	32,416

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £13,592 million (2014: £12,466 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:

	2015 £m	2014 £m
Not later than 1 year	**114**	109
Later than 1 year and not later than 5 years	**362**	349
Later than 5 years	**461**	497
Total operating lease commitments	**937**	955

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 23), there was no capital expenditure contracted but not provided for at 31 December 2015 (2014: £nil).

43 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.

		At fair value through profit or loss					
The Group	**Derivatives designated as hedging instruments £m**	**Held for trading £m**	**Designated upon initial recognition £m**	**Available-for-sale £m**	**Loans and receivables £m**	**Held at amortised cost £m**	**Total £m**
At 31 December 2015							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	2,481	2,481
Items in the course of collection from banks	–	–	–	–	–	172	172
Trading and other financial assets at fair value through profit or loss	–	4,230	1,598	–	–	–	5,828
Derivative financial instruments	4,208	10,718	–	–	–	–	14,926
Loans and receivables:							
Loans and advances to banks	–	–	–	–	691	–	691
Loans and advances to customers	–	–	–	–	270,837	–	270,837
Debt securities	–	–	–	–	182	–	182
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	31,560	–	31,560
	–	–	–	–	303,270	–	303,270
Available-for-sale financial assets	–	–	–	4,557	–	–	4,557
Total financial assets	4,208	14,948	1,598	4,557	303,270	2,653	331,234
Financial liabilities							
Deposits from banks	–	–	–	–	–	1,541	1,541
Customer deposits	–	–	–	–	–	190,046	190,046
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	80,047	80,047
Items in course of transmission to banks	–	–	–	–	–	342	342
Trading and other financial liabilities at fair value through profit or loss	–	4,414	1	–	–	–	4,415
Derivative financial instruments	2,102	10,642	–	–	–	–	12,744
Notes in circulation	–	–	–	–	–	1,112	1,112
Debt securities in issue	–	–	–	–	–	18,492	18,492
Financial guarantees	–	–	17	–	–	–	17
Subordinated liabilities	–	–	–	–	–	8,304	8,304
Total financial liabilities	2,102	15,056	18	–	–	299,884	317,060

43 Financial instruments (continued)

The 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	Total £m
At 31 December 2014							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	5,110	5,110
Items in the course of collection from banks	–	–	–	–	–	375	375
Trading and other financial assets at fair value through profit or loss	–	13,750	1,604	–	–	–	15,354
Derivative financial instruments	16,839	6,647	–	–	–	–	23,486
Loans and receivables:							
Loans and advances to banks	–	–	–	–	746	–	746
Loans and advances to customers	–	–	–	–	271,673	–	271,673
Debt securities	–	–	–	–	219	–	219
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	48,737	–	48,737
	–	–	–	–	321,375	–	321,375
Available-for-sale financial assets	–	–	–	5,567	–	–	5,567
Total financial assets	16,839	20,397	1,604	5,567	321,375	5,485	371,267
Financial liabilities							
Deposits from banks	–	–	–	–	–	2,291	2,291
Customer deposits	–	–	–	–	–	202,936	202,936
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	78,647	78,647
Items in course of transmission to banks	–	–	–	–	–	275	275
Trading and other financial liabilities at fair value through profit or loss	–	13,764	5	–	–	–	13,769
Derivative financial instruments	17,129	3,639	–	–	–	–	20,768
Debt securities in issue	–	–	–	–	–	20,408	20,408
Financial guarantees	–	–	21	–	–	–	21
Subordinated liabilities	–	–	–	–	–	9,783	9,783
Total financial liabilities	17,129	17,403	26	–	–	314,340	348,898

The Company	Derivatives held for trading, at fair value through profit or loss £m	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2015					
Financial assets					
Derivative financial instruments	**29**	**557**	**–**	**–**	**586**
Loans and receivables:					
Amounts due from fellow Lloyds Banking Group undertakings	**–**	**–**	**16,082**	**–**	**16,082**
Total financial assets	**29**	**557**	**16,082**	**–**	**16,668**
Financial liabilities					
Amounts owed to fellow Lloyds Banking Group undertakings	**–**	**–**	**–**	**10,286**	**10,286**
Subordinated liabilities	**–**	**–**	**–**	**5,958**	**5,958**
Total financial liabilities	**–**	**–**	**–**	**16,244**	**16,244**

43 Financial instruments (continued)

The Company	Derivatives held for trading, at fair value through profit or loss £m	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2014					
Financial assets					
Derivative financial instruments	26	616	–	–	642
Loans and receivables:					
Amounts due from fellow Lloyds Banking Group undertakings	–	–	18,448	–	18,448
Total financial assets	26	616	18,448	–	19,090
Financial liabilities					
Amounts owed to fellow Lloyds Banking Group undertakings	–	–	–	9,735	9,735
Subordinated liabilities	–	–	–	7,111	7,111
Total financial liabilities	–	–	–	16,846	16,846

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) Fair value measurement
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is a measure as at a specific date and may be significantly different from the amount which will actually be paid or received on maturity or settlement date.

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

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

The carrying amount of the following financial instruments is a reasonable approximation of fair value: cash and balances at central banks, items in the course of collection from banks, items in course of transmission to banks and notes in circulation.

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

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

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

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

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

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

43 Financial instruments (continued)

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

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

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

Transfers out of the level 3 portfolio arise when inputs that could have a significant impact on the instrument's valuation become market observable after previously having been non-market observable. In the case of asset-backed securities this can arise if more than one consistent independent source of data becomes available. Conversely transfers into the portfolio arise when consistent sources of data cease to be available.

(3) Financial assets and liabilities carried at fair value
(A) Financial assets, excluding derivatives
Valuation hierarchy
At 31 December 2015, the Group's financial assets carried at fair value, excluding derivatives, totalled £10,385 million (31 December 2014: £20,921 million). The table below analyses these financial assets by balance sheet classification, asset type and valuation methodology (level 1, 2 or 3, as described above). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

Valuation hierarchy

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2015				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	4,230	–	4,230
Corporate and other debt securities	–	1,372	–	1,372
Equity shares	–	–	226	226
Total trading and other financial assets at fair value through profit or loss	–	5,602	226	5,828
Available-for-sale financial assets				
Debt securities:				
Government securities	96	–	–	96
Bank and building society certificates of deposit	–	17	–	17
Mortgage-backed securities	–	82	–	82
Corporate and other debt securities	–	3,984	–	3,984
	96	4,083	–	4,179
Equity shares	1	38	339	378
Total available-for-sale financial assets	97	4,121	339	4,557
Total financial assets carried at fair value, excluding derivatives	97	9,723	565	10,385

43 Financial instruments (continued)

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2014				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	13,476	–	13,476
Loans and advances to banks	–	201	–	201
Debt securities:				
Government securities	45	–	–	45
Corporate and other debt securities	–	1,460	–	1,460
	45	1,460	–	1,505
Equity shares	–	–	172	172
Total trading and other financial assets at fair value through profit or loss	45	15,137	172	15,354
Available-for-sale financial assets				
Debt securities:				
Government securities	131	–	–	131
Bank and building society certificates of deposit	–	15	–	15
Asset-backed securities:				
Mortgage-backed securities	–	499	–	499
Other asset-backed securities	–	343	–	343
Corporate and other debt securities	–	4,268	–	4,268
	131	5,125	–	5,256
Equity shares	1	40	270	311
Total available-for-sale financial assets	132	5,165	270	5,567
Total financial assets carried at fair value, excluding derivatives	**177**	**20,302**	**442**	**20,921**

43 Financial instruments (continued)

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

	2015			2014		
The Group	**Trading and other financial assets at fair value through profit or loss £m**	**Available-for-sale £m**	**Total level 3 assets, excluding derivatives, carried at fair value (recurring basis) £m**	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Total level 3 assets, excluding derivatives, carried at fair value (recurring basis) £m
At 1 January	**172**	**270**	**442**	130	375	505
Exchange and other adjustments	**1**	**1**	**2**	2	(6)	(4)
Gains recognised in the income statement within other income	**87**	**–**	**87**	86	–	86
Gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	**–**	**11**	**11**	–	(61)	(61)
Purchases	**1**	**68**	**69**	56	229	285
Sales	**(35)**	**(11)**	**(46)**	(102)	(266)	(368)
Transfers into the level 3 portfolio	**–**	**–**	**–**	–	–	–
Transfers out of the level 3 portfolio	**–**	**–**	**–**	–	(1)	(1)
At 31 December	**226**	**339**	**565**	172	270	442
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**92**	**–**	**92**	27	–	27

Valuation methodology for financial assets, excluding derivatives
Loans and advances to customers and banks
These assets are principally reverse repurchase agreements. The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security purchased under the reserve repurchase agreement.

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

Where there is limited trading activity in debt securities, the Group uses valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes to determine an appropriate valuation. Debt securities are classified as level 3 if there is a significant valuation input that cannot be corroborated through market sources or where there are materially inconsistent values for an input. Asset classes classified as level 3 mainly comprise certain collateralised loan obligations and collateralised debt obligations.

Equity investments
Unlisted equity and fund investments are valued using different techniques in accordance with the Group's valuation policy and International Private Equity and Venture Capital Guidelines.

Depending on the business sector and the circumstances of the investment, unlisted equity valuations are based on earnings multiples, net asset values or discounted cash flows.

- A number of earnings multiples are used in valuing the portfolio including price earnings, earnings before interest and tax and earnings before interest, tax, depreciation and amortisation. The particular multiple selected being appropriate for the type of business being valued and is derived by reference to the current market-based multiple. Consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple.
- Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple.
- For fund investments the most recent capital account value calculated by the fund manager is used as the basis for the valuation and adjusted, if necessary, to align valuation techniques with the Group's valuation policy.

Unlisted equity investments and investments in property partnerships held in the life assurance funds are valued using third party valuations. Management take account of any pertinent information, such as recent transactions and information received on particular investments, to adjust the third party valuations where necessary.

43 Financial instruments (continued)

(B) Financial liabilities, excluding derivatives

Valuation hierarchy

At 31 December 2015, the Group's financial liabilities carried at fair value, excluding derivatives, totalled £4,432 million (31 December 2014: £13,790 million). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 73). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2015				
Trading and other financial liabilities at fair value through profit or loss:				
Liabilities held at fair value through profit or loss	**–**	**–**	**1**	**1**
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**–**	**4,414**	**–**	**4,414**
Short positions in securities	**–**	**–**	**–**	**–**
	–	**4,414**	**–**	**4,414**
Total trading and other financial liabilities at fair value through profit or loss	**–**	**4,414**	**1**	**4,415**
Financial guarantees	**–**	**–**	**17**	**17**
Total financial liabilities carried at fair value, excluding derivatives	**–**	**4,414**	**18**	**4,432**
At 31 December 2014				
Trading and other financial liabilities at fair value through profit and loss:				
Liabilities held at fair value through profit and loss	–	–	5	5
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	13,717	–	13,717
Short positions in securities	47	–	–	47
	47	13,717	–	13,764
Total trading and other financial liabilities at fair value through profit and loss	47	13,717	5	13,769
Financial guarantees	–	–	21	21
Total financial liabilities carried at fair value, excluding derivatives	47	13,717	26	13,790

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

	2015			2014		
The Group	**Trading and other financial liabilities at fair value through profit and loss £m**	**Financial guarantees £m**	**Total financial liabilities carried at fair value, excluding derivatives £m**	Trading and other financial liabilities at fair value through profit and loss £m	Financial guarantees £m	Total financial liabilities carried at fair value, excluding derivatives £m
At 1 January	**5**	**21**	**26**	39	17	56
(Gains) losses recognised in the income statement within other income	**–**	**(4)**	**(4)**	(5)	4	(1)
Redemptions	**(4)**	**–**	**(4)**	(29)	–	(29)
At 31 December	**1**	**17**	**18**	5	21	26
(Gains) losses recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December	**–**	**(4)**	**(4)**	–	4	4

Valuation methodology for financial liabilities, excluding derivatives

Trading liabilities in respect of securities sold under repurchase agreements

The fair value of these liabilities is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security sold under the repurchase agreement.

43 Financial instruments (continued)

(C) Derivatives

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2015, such assets totalled £14,926 million (31 December 2014: £23,486 million) and liabilities totalled £12,744 million (31 December 2014: £20,768 million). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 73). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

	2015				2014			
The Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	**–**	**14,584**	**342**	**14,926**	–	22,964	522	23,486
Derivative liabilities	**–**	**(12,706)**	**(38)**	**(12,744)**	–	(20,667)	(101)	(20,768)

Derivatives

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

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

Complex interest rate and foreign exchange products where there is significant dispersion of consensus pricing or where implied funding costs are material and unobservable are classified as level 3.

Where credit protection, usually in the form of credit default swaps, has been purchased or written on asset-backed securities, the security is referred to as a negative basis asset-backed security and the resulting derivative assets or liabilities have been classified as either level 2 or level 3 according to the classification of the underlying asset-backed security.

The table below analyses movements in level 3 derivative assets and liabilities carried at fair value. Following changes in the valuation methodology in 2015, uncollateralised inflation swaps are considered not to have significant unobservable inputs and have been transferred from level 3 to level 2.

	2015		2014	
The Group	**Derivative assets £m**	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	**522**	**(101)**	440	(46)
Exchange and other adjustments	**(19)**	**–**	(9)	1
Gains recognised in the income statement within other income	**22**	**(6)**	158	–
Purchases (additions)	**–**	**–**	–	(58)
(Sales) redemptions	**(51)**	**29**	(14)	2
Transfers out of the level 3 portfolio	**(132)**	**40**	(53)	–
At 31 December	**342**	**(38)**	522	(101)
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December	**8**	**(1)**	158	(58)

43 Financial instruments (continued)

Derivative valuation adjustments
Derivative financial instruments which are carried in the balance sheet at fair value are adjusted where appropriate to reflect credit risk, market liquidity and other risks.

(i) Uncollateralised derivative valuation adjustments, excluding monoline counterparties
The following table summarises the movement on this valuation adjustment account for the Group during 2015 and 2014.

	2015 £m	2014 £m
At 1 January	**178**	219
Income statement (credit) charge	**(14)**	(46)
Transfers	**27**	5
At 31 December	**191**	178

Represented by:

	2015 £m	2014 £m
Credit Valuation Adjustment	**156**	170
Debit Valuation Adjustment	**(10)**	(12)
Funding Valuation Adjustment	**45**	20
	191	178

Credit and Debit Valuation Adjustments (CVA and DVA) are applied to the Group's over-the-counter derivative exposures with counterparties that are not subject to standard interbank collateral arrangements. These exposures largely relate to the provision of risk management solutions for corporate customers within the Commercial Banking division.

A CVA is taken where the Group has a positive future uncollateralised exposure (asset). A DVA is taken where the Group has a negative future uncollateralised exposure (liability). These adjustments reflect interest rates and expectations of counterparty creditworthiness and the Group's own credit spread respectively.

The CVA is sensitive to:

– the current size of the mark-to-market position on the uncollateralised asset;
– expectations of future market volatility of the underlying asset; and
– expectations of counterparty creditworthiness.

In circumstances where exposures to a counterparty become impaired, any associated derivative valuation adjustment is transferred and assessed for specific loss alongside other non-derivative assets and liabilities that the counterparty may have with the Group.

Market Credit Default Swap (CDS) spreads are used to develop the probability of default for quoted counterparties. For unquoted counterparties, internal credit ratings and market sector CDS curves and recovery rates are used. The Loss Given Default (LGD) is based on market recovery rates and internal credit assessments.

The combination of a one notch deterioration in the credit rating of derivative counterparties and a ten per cent increase in LGD increases the CVA by £30 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (in total contributing £nil of the overall CVA balance at 31 December 2015).

The DVA is sensitive to:

– the current size of the mark-to-market position on the uncollateralised liability;
– expectations of future market volatility of the underlying liability; and
– the Group's own CDS spread.

A one per cent rise in the CDS spread would lead to an increase in the DVA of £15 million to £25 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A one per cent rise in interest rates would lead to a £79 million fall in the overall valuation adjustment to £67 million. The CVA model used by the Group does not assume any correlation between the level of interest rates and default rates.

The Group has also recognised a Funding Valuation Adjustment to adjust for the net cost of funding uncollateralised derivative positions. This adjustment is calculated on the expected future exposure discounted at a suitable cost of funds. A ten basis points increase in the cost of funds will increase the funding valuation adjustment by approximately £8 million.

(ii) Market liquidity
The Group includes mid to bid-offer valuation adjustments against the expected cost of closing out the net market risk in the Group's trading positions within a timeframe that is consistent with historical trading activity and spreads that the trading desks have accessed historically during the ordinary course of business in normal market conditions.

At 31 December 2015, the Group's derivative trading business held mid to bid-offer valuation adjustments of £8 million (2014: £8 million).

43 Financial instruments (continued)

(D) Sensitivity of level 3 valuations

	Valuation techniques	Significant unobservable inputs[1]	At 31 December 2015 Carrying value £m	At 31 December 2015 Effect of reasonably possible alternative assumptions[2] Favourable changes £m	At 31 December 2015 Effect of reasonably possible alternative assumptions[2] Unfavourable changes £m	At 31 December 2014 Carrying value £m	At 31 December 2014 Effect of reasonably possible alternative assumptions[2] Favourable changes £m	At 31 December 2014 Effect of reasonably possible alternative assumptions[2] 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	**226**	**21**	**(26)**	172	26	(23)
			226			172		
Available-for-sale financial assets								
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**339**	**25**	**(27)**	270	10	(18)
			339			270		
Derivative financial assets								
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (55bps/107bps)	**–**	**–**	**–**	139	2	(2)
	Option pricing model	Interest rate volatility (1%/63%)	**342**	**3**	**(1)**	383	–	–
			342			522		
Level 3 financial assets carried at fair value			**907**			964		
Trading and other financial liabilities at fair value through profit and loss			**1**	**–**	**–**	5	–	–
Derivative financial liabilities								
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (55bps/107bps)	**–**	**–**	**–**	40	–	–
	Option pricing model	Interest rate volatility (1%/63%)	**38**	**–**	**–**	61	–	–
			38			101		
Financial guarantees			**17**			21		
Level 3 financial liabilities carried at fair value			**56**			127		

[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.

43 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 55 bps and 107 bps (2014: 3 bps and 167 bps).
- Swaptions are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities have been flexed within a range of 1 per cent to 63 per cent (2014: 4 per cent and 120 per cent).

Unlisted equity, venture capital investments and investments in property partnerships

The valuation techniques used for unlisted equity and venture capital investments vary depending on the nature of the investment. Reasonably possible alternative valuations for these investments have been calculated by reference to the approach taken, as appropriate to the business sector and investment circumstances and as such the following inputs have been considered:

- for valuations derived from earnings multiples, consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple;
- the discount rates used in discounted cash flow valuations; and
- in line with International Private Equity and Venture Capital Guidelines, the values of underlying investments in fund investments portfolios.

(4) Financial assets and liabilities carried at amortised cost

(A) Financial assets

Valuation hierarchy

The table below analyses the fair values of the financial assets of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 73). Loans and receivables are mainly classified as level 3 due to significant unobservable inputs used in the valuation models. Where inputs are observable, debt securities are classified as level 1 or 2.

			Valuation hierarchy		
The Group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2015					
Loans and receivables:					
Loans and advances to customers	**270,837**	**272,000**	**–**	**–**	**272,000**
Loans and advances to banks	**691**	**691**	**–**	**–**	**691**
Debt securities	**182**	**160**	**7**	**145**	**8**
Due from fellow Lloyds Banking Group undertakings	**31,560**	**31,560**	**–**	**–**	**31,560**
Reverse repos included in above amounts:					
Loans and advances to customers	**–**	**–**	**–**	**–**	**–**
Loans and advances to banks	**–**	**–**	**–**	**–**	**–**
At 31 December 2014					
Loans and receivables:					
Loans and advances to customers	271,673	271,240	–	–	271,240
Loans and advances to banks	746	745	–	–	745
Debt securities	219	209	7	161	41
Due from fellow Lloyds Banking Group undertakings	48,737	48,737	–	–	48,737
Reverse repos included in above amounts:					
Loans and advances to customers	–	–	–	–	–
Loans and advances to banks	–	–	–	–	–

Valuation methodology

Loans and advances to customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates due to their short term nature. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value.

To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is usually estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair value of commercial loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. No adjustment is made to put it in place by the Group to manage its interest rate exposure.

43 Financial instruments (continued)

Loans and advances to banks
The carrying value of short dated loans and advances to banks is assumed to be their fair value. The fair value of loans and advances to banks is estimated by discounting the anticipated cash flows at a market discount rate adjusted for the credit spread of the obligor or, where not observable, the credit spread of borrowers of similar credit quality.

Debt securities
The fair values of debt securities, which were previously within assets held for trading and were reclassified to loans and receivables, are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

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

(B) Financial liabilities

Valuation hierarchy
The table below analyses the fair values of the financial liabilities of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 73).

			Valuation hierarchy		
The Group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2015					
Deposits from banks	**1,541**	**1,541**	**–**	**1,541**	**–**
Customer deposits	**190,046**	**189,764**	**–**	**178,702**	**11,062**
Due to fellow Lloyds Banking Group undertakings	**80,047**	**80,047**	**–**	**80,047**	**–**
Debt securities in issue	**18,492**	**18,159**	**–**	**15,259**	**2,900**
Subordinated liabilities	**8,304**	**7,970**	**–**	**7,970**	**–**
Repos included in above amounts:					
Deposits from banks	**17**	**17**	**–**	**17**	**–**
Customer deposits	**–**	**–**	**–**	**–**	**–**
At 31 December 2014[1]					
Deposits from banks	2,291	2,297	–	2,297	–
Customer deposits	202,936	203,631	–	188,700	14,931
Due to fellow Lloyds Banking Group undertakings	78,647	78,647	–	78,647	–
Debt securities in issue	20,408	20,011	–	20,011	–
Subordinated liabilities	9,783	8,765	–	8,765	–
Repos included in above amounts:					
Deposits from banks	595	595	–	595	–
Customer deposits	–	–	–	–	–

[1]Restated – see note 1.

The carrying amount of items in course of transmission to banks and notes in circulation is a reasonable approximation of fair value.

Valuation methodology
Deposits from banks and customer deposits
The fair value of bank and customer deposits repayable on demand is assumed to be equal to their carrying value.

The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue
The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities is calculated based on quoted market prices where available. Where quoted market prices are not available, fair value is estimated using discounted cash flow techniques at a rate which reflects market rates of interest and the Group's own credit spread.

Subordinated liabilities
The fair value of subordinated liabilities is determined by reference to quoted market prices where available or by reference to quoted market prices of similar instruments. Subordinated liabilities are classified as level 2, since the inputs used to determine their fair value are largely observable.

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

(5) Reclassification of financial assets
No financial assets were reclassified in 2014 or 2015.

44 Transfers of financial assets

(1) Transferred financial assets that continue to be recognised in full
The Group enters into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets covered as substantially all of the risks and rewards, including credit, interest rate, prepayment and other price risks are retained by the Group. In all cases, the transferee has the right to sell or repledge the assets concerned.

As set out in note 16, 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 28). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

	At 31 December 2015		At 31 December 2014	
The Group	**Carrying value of transferred assets £m**	**Carrying value of associated liabilities £m**	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
Repurchase and securities lending transactions				
Trading and other financial assets at fair value through profit or loss	**–**	**–**	73	77
Available-for-sale financial assets	**102**	**17**	1,491	1,004
Loans and receivables:				
Loans and advances to customers	**22,170**	**–**	27,651	896
Debt securities classified as loans and receivables	**75**	**–**	821	–
Securitisation programmes				
Loans and receivables:				
Loans and advances to customers[1]	**35,807**	**6,417**	43,090	7,014

[1] The carrying value of associated liabilities for the Group excludes securitisation notes held by the Group of £19,208 million (2014: £20,609 million).

(2) Transferred financial assets derecognised in their entirety with ongoing exposure
No such assets remained at 31 December 2014 or 2015.

45 Offsetting of financial assets and liabilities

The following information relates to financial assets and liabilities which have been offset in the balance sheet and those which have not been offset but for which the Group has enforceable master netting agreements in place with counterparties.

At 31 December 2015	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/ pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	1,598	–	1,598	–	–	1,598
Reverse repos	4,230	–	4,230	–	(4,230)	–
	5,828	–	5,828	–	(4,230)	1,598
Derivative financial instruments	14,926	–	14,926	(1,280)	(1,908)	11,738
Loans and advances to banks:						
Excluding reverse repos	691	–	691	(303)	–	388
Reverse repos	–	–	–	–	–	–
	691	–	691	(303)	–	388
Loans and advances to customers:						
Excluding reverse repos	270,837	–	270,837	(81)	(1,067)	269,689
Reverse repos	–	–	–	–	–	–
	270,837	–	270,837	(81)	(1,067)	269,689
Debt securities	182	–	182	–	–	182
Available-for-sale financial assets	4,557	–	4,557	–	(16)	4,541
Financial liabilities						
Deposits from banks:						
Excluding repos	1,524	–	1,524	(1,220)	–	304
Repos	17	–	17	–	(17)	–
	1,541	–	1,541	(1,220)	(17)	304
Customer deposits:						
Excluding repos	190,046	–	190,046	(60)	(1,067)	188,919
Repos	–	–	–	–	–	–
	190,046	–	190,046	(60)	(1,067)	188,919
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	1	–	1	–	–	1
Repos	4,414	–	4,414	–	(4,414)	–
	4,415	–	4,415	–	(4,414)	1
Derivative financial instruments	12,744	–	12,744	(384)	(1,900)	10,460

45 Offsetting of financial assets and liabilities (continued)

At 31 December 2014	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3] Cash collateral received/ pledged £m	Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	1,677	–	1,677	–	(45)	1,632
Reverse repos	13,747	(70)	13,677	–	(13,677)	–
	15,424	(70)	15,354	–	(13,722)	1,632
Derivative financial instruments	23,486	–	23,486	(1,286)	(3,773)	18,427
Loans and advances to banks:						
Excluding reverse repos	746	–	746	(414)	–	332
Reverse repos	–	–	–	–	–	–
	746	–	746	(414)	–	332
Loans and advances to customers:						
Excluding reverse repos	271,673	–	271,673	(205)	(1,730)	269,738
Reverse repos	–	–	–	–	–	–
	271,673	–	271,673	(205)	(1,730)	269,738
Debt securities	219	–	219	–	–	219
Available-for-sale financial assets	5,567	–	5,567	–	(13)	5,554
Financial liabilities						
Deposits from banks:						
Excluding repos	1,696	–	1,696	(1,264)	–	432
Repos	595	–	595	–	(595)	–
	2,291	–	2,291	(1,264)	(595)	432
Customer deposits:						
Excluding repos	202,936	–	202,936	(22)	(1,147)	201,767
Repos	–	–	–	–	–	–
	202,936	–	202,936	(22)	(1,147)	201,767
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	52	–	52	–	–	52
Repos	13,787	(70)	13,717	–	(13,717)	–
	13,839	(70)	13,769	–	(13,717)	52
Derivative financial instruments	20,768	–	20,768	(619)	(3,760)	16,389

[1] After impairment allowance.

[2] The amounts set off in the balance sheet as shown above represent balances with central clearing houses which meet the criteria for offsetting under IAS 32.

[3] The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respect of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

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

46 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. 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.

A. Maximum credit exposure

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

	At 31 December 2015			At 31 December 2014		
The Group	**Maximum exposure £m**	**Offset[2] £m**	**Net exposure £m**	Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and receivables:						
Loans and advances to banks, net[1]	**691**	**–**	**691**	746	–	746
Loans and advances to customers, net[1]	**270,837**	**(1,067)**	**269,770**	271,673	(1,147)	270,526
Debt securities, net[1]	**182**	**–**	**182**	219	–	219
	271,710	**(1,067)**	**270,643**	272,638	(1,147)	271,491
Available-for-sale financial assets[3]	**4,179**	**–**	**4,179**	5,256	–	5,256
Trading and other financial assets at fair value through profit or loss[3]:						
Loans and advances	**4,230**	**–**	**4,230**	13,677	–	13,677
Debt securities, treasury and other bills	**1,372**	**–**	**1,372**	1,505	–	1,505
	5,602	**–**	**5,602**	15,182	–	15,182
Derivative assets	**14,926**	**(1,898)**	**13,028**	23,486	(3,713)	19,773
Financial guarantees	**229**	**–**	**229**	440	–	440
Off-balance sheet items:						
Acceptances and endorsements	**–**	**–**	**–**	1	–	1
Other items serving as direct credit substitutes	**15**	**–**	**15**	8	–	8
Performance bonds and other transaction-related contingencies	**90**	**–**	**90**	220	–	220
Irrevocable commitments	**13,592**	**–**	**13,592**	12,466	–	12,466
	13,697	**–**	**13,697**	12,695	–	12,695
	310,343	**(2,965)**	**307,378**	329,697	(4,860)	324,837

[1]Amounts shown net of related impairment allowances.

[2]Offset items comprise deposit amounts available for offset and amounts available for offset under master netting arrangements that do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[3]Excludes equity shares.

B. Concentrations of exposure

The Group's management of concentration risk includes single name, industry sector and country limits as well as controls over the Group's overall exposure to certain products. Further information on the Group's management of this risk is included within Credit risk on page 4.

At 31 December 2015 the most significant concentrations of exposure were in mortgages (comprising 90 per cent of total loans and advances to customers) and other personal lending (comprising 4 per cent of the total). For further information on concentrations of the Group's loans, refer to note 15.

Following the continuing reduction in the Group's non-UK activities, an analysis of credit risk exposures by geographical region has not been provided.

46 Financial risk management (continued)

C. Credit quality of assets

Loans and receivables

The analysis of lending between retail and commercial has been prepared based upon the type of exposure. Included within retail are exposures to personal customers and small businesses, whilst included within commercial are exposures to corporate customers and other large institutions.

Loans and advances – The Group

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss[1] £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
31 December 2015						
Neither past due nor impaired	**686**	**235,356**	**9,776**	**15,161**	**260,293**	**–**
Past due but not impaired	**5**	**7,022**	**147**	**132**	**7,301**	**–**
Impaired – no provision required	**–**	**411**	**211**	**546**	**1,168**	**–**
– provision held	**–**	**3,111**	**219**	**1,555**	**4,885**	**–**
Gross	**691**	**245,900**	**10,353**	**17,394**	**273,647**	**–**
Allowance for impairment losses (note 18)	**–**	**(1,479)**	**(182)**	**(1,149)**	**(2,810)**	**–**
Net balance sheet carrying value	**691**				**270,837**	**–**
31 December 2014						
Neither past due nor impaired	717	229,040	8,445	21,255	258,740	1,140
Past due but not impaired	29	8,479	133	172	8,784	–
Impaired – no provision required	–	273	275	271	819	–
– provision held	–	3,399	241	5,373	9,013	–
Gross	746	241,191	9,094	27,071	277,356	1,140
Allowance for impairment losses (note 18)	–	(1,483)	(200)	(4,000)	(5,683)	–
Net balance sheet carrying value	746				271,673	1,140

[1]Excludes amounts due from fellow Lloyds Banking Group undertakings.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(h). Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £2,157 million (2014: £5,748 million).

46 Financial risk management (continued)

Loans and advances which are neither past due nor impaired – The Group

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2015						
Good quality	**655**	**234,715**	**8,108**	**6,188**		**–**
Satisfactory quality	**23**	**509**	**1,442**	**4,842**		**–**
Lower quality	**4**	**26**	**154**	**3,804**		**–**
Below standard, but not impaired	**4**	**106**	**72**	**327**		**–**
Total loans and advances which are neither past due nor impaired	**686**	**235,356**	**9,776**	**15,161**	**260,293**	**–**
31 December 2014						
Good quality	605	227,750	6,435	7,653		1,140
Satisfactory quality	43	1,096	1,712	5,503		–
Lower quality	48	71	186	6,786		–
Below standard, but not impaired	21	123	112	1,313		–
Total loans and advances which are neither past due nor impaired	717	229,040	8,445	21,255	258,740	1,140

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and commercial are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Commercial lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models.

Loans and advances which are past due but not impaired – The Group

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2015						
0-30 days	**5**	**3,484**	**98**	**66**	**3,648**	**–**
30-60 days	**–**	**1,464**	**38**	**22**	**1,524**	**–**
60-90 days	**–**	**912**	**5**	**11**	**928**	**–**
90-180 days	**–**	**1,162**	**1**	**4**	**1,167**	**–**
Over 180 days	**–**	**–**	**5**	**29**	**34**	**–**
Total loans and advances which are past due but not impaired	**5**	**7,022**	**147**	**132**	**7,301**	**–**
31 December 2014						
0-30 days	29	3,976	90	114	4,180	–
30-60 days	–	1,901	38	15	1,954	–
60-90 days	–	1,175	5	38	1,218	–
90-180 days	–	1,427	–	4	1,431	–
Over 180 days	–	–	–	1	1	–
Total loans and advances which are past due but not impaired	29	8,479	133	172	8,784	–

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

46 Financial risk management (continued)

Debt securities classified as loans and receivables – The Group

An analysis by credit rating of debt securities classified as loans and receivables is provided below:

	2015			2014		
	Investment grade[1] £m	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Asset-backed securities:						
Mortgage-backed securities	**30**	**–**	**30**	30	–	30
Other asset-backed securities	**135**	**7**	**142**	143	7	150
	165	**7**	**172**	173	7	180
Corporate and other debt securities	**–**	**123**	**123**	1	181	182
Gross exposure	**165**	**130**	**295**	174	188	362
Allowance for impairment losses			**(113)**			(143)
Total debt securities classified as loans and receivables			**182**			219

[1]Credit ratings equal to or better than 'BBB'.
[2]Other comprises sub-investment grade (2015: £nil; 2014: £nil) and not rated (2015: £130 million; 2014: £188 million).

Available-for-sale financial assets (excluding equity shares) – The Group

An analysis of available-for-sale financial assets is included in note 19. The credit quality of available-for-sale financial assets (excluding equity shares) is set out below:

	2015			2014		
	Investment grade[1] £m	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities:						
Government securities	**96**	**–**	**96**	131	–	131
Bank and building society certificates of deposit	**17**	**–**	**17**	15	–	15
Asset-backed securities:						
Mortgage-backed securities	**82**	**–**	**82**	499	–	499
Other asset-backed securities	**–**	**–**	**–**	343	–	343
	82	**–**	**82**	842	–	842
Corporate and other debt securities	**3,984**	**–**	**3,984**	4,268	–	4,268
	4,179	**–**	**4,179**	5,256	–	5,256
Due from fellow Group undertakings			**–**			–
Total held as available-for-sale financial assets			**4,179**			5,256

[1]Credit ratings equal to or better than 'BBB'.
[2]Other comprises sub-investment grade (2015: £nil; 2014: £nil) and not rated (2015: £nil; 2014: £nil).

46 Financial risk management (continued)

Debt securities, treasury and other bills held at fair value through profit or loss – The Group
An analysis of trading and other financial assets at fair value through profit or loss is included in note 12. The credit quality of debt securities, treasury and other bills held at fair value through profit or loss is set out below.

	2015			2014		
	Investment grade[1] £m	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities, treasury and other bills held at fair value through profit or loss						
Trading assets						
Government securities	–	–	–	45	–	45
Corporate and other debt securities	–	–	–	28	–	28
Total debt securities held as trading assets	–	–	–	73	–	73
Treasury and other bills	–	–	–	–	–	–
Total held as trading assets	–	–	–	73	–	73
Due from fellow Group undertakings			–			–
Total held at fair value through profit or loss			–			73

[1]Credit ratings equal to or better than 'BBB'.
[2]Other comprises sub-investment grade (2015: £nil; 2014: £nil) and not rated (2015: £nil; 2014: £nil).

Derivative assets – The Group
An analysis of derivative assets is given in note 13. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £13,028 million (2014: £19,773 million), cash collateral of £1,280 million (2014: £1,286 million) was held and a further £84 million was due from OECD banks (2014: £216 million).

	2015			2014		
	Investment grade[1] £m	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Derivative financial instruments						
Trading and other	**3,945**	**565**	**4,510**	5,167	1,348	6,515
Hedging	**1,209**	**1**	**1,210**	2,082	22	2,104
	5,154	**566**	**5,720**	7,249	1,370	8,619
Due from fellow Group undertakings			**9,206**			14,867
Total derivative financial instruments			**14,926**			23,486

[1]Credit ratings equal to or better than 'BBB'.
[2]Other comprises sub-investment grade (2015: £564 million; 2014: £945 million) and not rated (2015: £2 million; 2014: £425 million).

Financial guarantees and irrevocable loan commitments
Financial guarantees represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

D. Collateral held as security for financial assets
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 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
These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

46 Financial risk management (continued)

Loans and advances to customers

Retail lending

Mortgages

An analysis by loan-to-value ratio of the Group's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations.

	2015				2014			
	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70 per cent	**159,955**	**4,135**	**1,628**	**165,718**	137,305	3,907	1,314	142,526
70 per cent to 80 per cent	**37,782**	**1,163**	**573**	**39,518**	45,475	1,674	615	47,764
80 per cent to 90 per cent	**22,914**	**804**	**461**	**24,179**	25,382	1,270	594	27,246
90 per cent to 100 per cent	**9,042**	**524**	**330**	**9,896**	12,417	846	416	13,679
Greater than 100 per cent	**5,663**	**396**	**530**	**6,589**	8,461	782	733	9,976
Total	**235,356**	**7,022**	**3,522**	**245,900**	229,040	8,479	3,672	241,191

Other

The majority of non-mortgage retail lending is unsecured. At 31 December 2015, impaired non-mortgage lending amounted to £247 million, net of an impairment allowance of £182 million (2014: £316 million net of an impairment allowance of £200 million). The fair value of the collateral held in respect of this lending was £nil (2014: £nil). 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 £9,923 million (2014: £8,578 million). Lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination and are thereafter monitored in accordance with business unit credit policy.

The Group credit risk disclosures for unimpaired non-mortgage retail lending report assets gross of collateral and therefore disclose the maximum loss exposure. The Group believes that this approach is appropriate. The value of collateral is reassessed if there is observable evidence of distress of the borrower. Unimpaired non-mortgage retail lending, including any associated collateral, is managed on a customer-by-customer basis rather than a portfolio basis. No aggregated collateral information for the entire unimpaired non-mortgage retail lending portfolio is provided to key management personnel.

Commercial lending

Impaired secured lending

The value of collateral is re-evaluated and its legal soundness re-assessed if there is observable evidence of distress of the borrower; this evaluation is used to determine potential loss allowances and management's strategy to try to either repair the business or recover the debt.

At 31 December 2015, impaired secured commercial lending amounted to £530 million, net of an impairment allowance of £467 million (2014: £1,525 million, net of an impairment allowance of £3,614 million). The fair value of the collateral held in respect of impaired secured commercial lending was £265 million (2014: £1,619 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured commercial lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Impaired secured commercial lending and associated collateral relates to lending to property companies and to customers in the financial, business and other services; transport, distribution and hotels; and construction industries.

Unimpaired secured lending

Unimpaired secured commercial lending amounted to £7,111 million (2014: £10,525 million).

For unimpaired secured commercial lending, the Group reports assets gross of collateral and therefore discloses the maximum loss exposure. The Group believes that this approach is appropriate as collateral values at origination and during a period of good performance may not be representative of the value of collateral if the obligor enters a distressed state.

Unimpaired secured commercial lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for impaired lending, this will not always involve assessing it on a fair value basis. No aggregated collateral information for the entire unimpaired secured commercial lending portfolio is provided to key management personnel.

Trading and other financial assets at fair value through profit or loss (excluding equity shares)

Included in trading and other financial assets at fair value through profit or loss are repurchase agreements treated as collateralised loans with a carrying value of £4,230 million (2014: £13,677 million). Collateral is held with a fair value of £3,794 million (2014: £13,422 million), all of which the Group is able to repledge. At 31 December 2015, £666 million had been repledged (2014: £3,759 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £nil (2014: £24,554 million). At 31 December 2014 £20,245 million of this amount 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.

46 Financial risk management (continued)

Derivative assets, after offsetting of amounts under master netting arrangements
The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £13,028 million (2014: £19,773 million), cash collateral of £1,280 million (2014: £1,286 million) was held.

Irrevocable loan commitments and other credit-related contingencies
At 31 December 2015, there were irrevocable loan commitments and other credit-related contingencies of £13,697 million (2014: £12,695 million). Collateral is held as security, in the event that lending is drawn down, on £9,551 million (2014: £8,395 million) of these balances.

Collateral repossessed
During the year, £182 million of collateral was repossessed (2014: £720 million), consisting primarily of residential property. In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against commercial lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

E. Collateral pledged as security
The Group pledges assets primarily for repurchase agreements and securities lending transactions which are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

Repurchase transactions
Deposits from banks
Included in deposits from banks are deposits held as collateral for facilities granted, with a carrying value of £17 million (2014: £595 million) and a fair value of £17 million (2014: £595 million).

Trading and other financial liabilities at fair value through profit or loss
The fair value of collateral pledged in respect of repurchase transactions, accounted for as secure borrowing, where the secured party is permitted by contract or custom to repledge was £4,180 million (2014: £13,935 million).

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

The Group	**2015 £m**	2014 £m
Loans and advances to customers	**22,170**	26,703
Debt securities classified as loans and receivables	**75**	821
Available-for-sale financial assets	**86**	464
	22,331	27,988

Securitisation and covered bonds
In addition to the assets detailed above, the Group also holds assets that are encumbered through the Group's securitisation and covered bond programmes. Further details of these assets are provided in notes 16 and 17.

(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 2015 the aggregate notional principal of interest rate swaps designated as fair value hedges was £21,646 million (2014: £22,789 million) with a net fair value asset of £2,574 million (2014: £3,389 million) (see note 13). The losses on the hedging instruments were £459 million (2014: gains of £579 million). The gains on the hedged items attributable to the hedged risk were £457 million (2014: losses of £557 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 commercial 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 2015 was £44,922 million (2014: £71,379 million) with a net fair value liability of £476 million (2014: liability of £417 million) (see note 13). In 2015, ineffectiveness recognised in the income statement that arises from cash flow hedges was £nil (2014: £nil).

46 Financial risk management (continued)

Currency risk
The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the central market and liquidity risk function in London.

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. At 31 December 2015 the aggregate principal of these currency borrowings was £233 million (2014: £170 million). In 2015, an ineffectiveness gain of £1 million before tax and £1 million after tax (2014: £nil) was recognised in the income statement arising from net investment hedges.

The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

Functional currency of Group operations

The Group	Euro £m	US Dollar £m	Other non-sterling £m
31 December 2015			
Gross exposure	**102**	**126**	**1**
Net investment hedge	**(101)**	**(132)**	**–**
Total structural foreign currency exposures, after net investment hedges	**1**	**(6)**	**1**
31 December 2014			
Gross exposure	120	108	1
Net investment hedge	(60)	(110)	–
Total structural foreign currency exposures, after net investment hedges	60	(2)	1

(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. Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The table below analyses financial instrument liabilities of the Group, 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.

The Group	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2015						
Deposits from banks	**36**	**–**	**9**	**1,496**	**–**	**1,541**
Customer deposits	**137,615**	**7,667**	**23,898**	**21,546**	**901**	**191,627**
Trading liabilities	**4,415**	**–**	**–**	**–**	**1**	**4,416**
Debt securities in issue	**503**	**261**	**3,441**	**8,967**	**7,337**	**20,509**
Subordinated liabilities	**120**	**232**	**992**	**4,147**	**5,593**	**11,084**
Total non-derivative financial liabilities	**142,689**	**8,160**	**28,340**	**36,156**	**13,832**	**229,177**
Derivative financial liabilities:						
Gross settled derivative – outflow	**169**	**190**	**752**	**2,851**	**4,263**	**8,225**
Gross settled derivative – inflow	**(57)**	**(150)**	**(731)**	**(2,787)**	**(3,770)**	**(7,495)**
Gross settled derivative – netflow	**112**	**40**	**21**	**64**	**493**	**730**
Net settled derivative liabilities	**2,131**	**27**	**92**	**307**	**360**	**2,917**
Total derivative financial liabilities	**2,243**	**67**	**113**	**371**	**853**	**3,647**

46 Financial risk management (continued)

The Group	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2014						
Deposits from banks	16	585	179	1,300	163	2,243
Customer deposits	146,908	4,572	29,232	24,156	70	204,938
Trading liabilities	12,224	604	633	303	5	13,769
Debt securities in issue	1,619	142	3,066	12,348	6,726	23,901
Subordinated liabilities	298	877	651	5,188	5,745	12,759
Total non-derivative financial liabilities	161,065	6,780	33,761	43,295	12,709	257,610
Derivative financial liabilities:						
Gross settled derivative – outflow	986	1,617	2,808	6,863	7,573	19,847
Gross settled derivative – inflow	(789)	(1,466)	(2,779)	(6,667)	(6,941)	(18,642)
Gross settled derivative – netflow	197	151	29	196	632	1,205
Net settled derivative liabilities	3,697	32	142	451	441	4,763
Total derivative financial liabilities	3,894	183	171	647	1,073	5,968

The Company	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2015						
Amounts owed to fellow Group undertakings	**–**	**–**	**–**	**–**	**10,286**	**10,286**
Subordinated liabilities	**–**	**202**	**643**	**3,020**	**2,752**	**6,617**
Total non-derivative financial liabilities	**–**	**202**	**643**	**3,020**	**13,038**	**16,903**
At 31 December 2014						
Amounts owed to fellow Group undertakings	–	–	–	–	9,735	9,735
Subordinated liabilities	–	847	198	3,180	2,069	6,294
Total non-derivative financial liabilities	–	847	198	3,180	11,804	16,029

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 £229 million at 31 December 2015 (2014: £440 million) with £39 million expiring within one year; £26 milion between one and three years; £30 million between three and five years; and £134 million over five years (2014: £338 million expiring within one year; £48 million between one and three years; £27 million between three and five years; and £27 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 (2014: £12 million) for the Group and £1 million (2014: £5 million) 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 following tables set out the amounts and residual maturities of the Group's off balance sheet contingent liabilities and commitments.

The Group	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2015					
Acceptances and endorsements	**–**	**–**	**–**	**–**	**–**
Other contingent liabilities	**84**	**6**	**–**	**15**	**105**
Total contingent liabilities	**84**	**6**	**–**	**15**	**105**
Lending commitments	**30,114**	**1,458**	**666**	**1,945**	**34,183**
Other commitments	**–**	**–**	**–**	**23**	**23**
Total commitments	**30,114**	**1,458**	**666**	**1,968**	**34,206**
Total contingents and commitments	**30,198**	**1,464**	**666**	**1,983**	**34,311**

46 Financial risk management (continued)

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2014					
Acceptances and endorsements	–	–	–	1	1
Other contingent liabilities	216	2	6	4	228
Total contingent liabilities	216	2	6	5	229
Lending commitments	28,431	920	538	2,526	32,415
Other commitments	1	–	–	–	1
Total commitments	28,432	920	538	2,526	32,416
Total contingents and commitments	28,648	922	544	2,531	32,645

47 Capital

Capital management
Within the Group, capital within each regulated entity is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in 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 evolving regulatory requirements, expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight.

The Group measures the amount of capital it holds using the regulatory framework defined by the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulation Authority (PRA) policy statement PS7/13. Application of CRD IV requirements is subject to transitional phasing permitted by PS7/13.

The minimum amount of total capital, under Pillar 1 of the regulatory framework, is determined as 8 per cent of the aggregate risk-weighted assets calculated in respect of credit risk, counterparty credit risk, operational risk and market risk. At least 4.5 per cent of risk-weighted assets are required to be covered by Common Equity Tier 1 (CET1) capital.

The minimum requirement for capital is supplemented by Pillar 2 of the framework. Under Pillar 2A, additional requirements are set through the issuance of bank specific Individual Capital Guidance (ICG), which adjusts the Pillar 1 minimum for those risks not covered or not fully covered under Pillar 1. A key input into the PRA's ICG process is a bank's own assessment of the amount of capital it needs, a process known as the Internal Capital Adequacy Assessment Process (ICAAP).

A range of additional bank specific regulatory capital buffers apply under CRD IV. These include a time-varying countercyclical capital buffer for which the Group currently has a negligible requirement based on its minimal exposures to those jurisdictions that have set countercyclical buffer rates. Other capital buffers do not currently apply to the Group as they are either subject to phase in periods (commencing 2016) or are applied at the discretion of the regulator.

During the year, the individual regulated entities within the Group and the Group itself complied with all of the externally imposed capital requirements to which they are subject.

Regulatory capital developments
The regulatory framework within which the Group operates continues to be developed at a global level through the Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS), at a European level mainly through the issuance of CRD IV technical standards and guidelines and within the UK by the PRA and through directions from the Financial Policy Committee (FPC).The Group continues to monitor these developments very closely, analysing potential capital impacts to ensure the Group and individual regulated entities continue to maintain a strong capital position that exceeds the minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Capital resources
Regulatory capital is divided into tiers depending on the degree of permanency and ability to absorb losses.

- Common equity tier 1 capital represents the strongest form of capital consisting of shareholders' equity after a number of regulatory adjustments and deductions are applied. These include deductions for deferred tax assets, subject to threshold requirements under CRD IV, and the elimination of the cash flow hedging reserve, goodwill, other intangible assets and defined benefit pension surpluses.
- Fully qualifying additional tier 1 (AT1) capital comprises non-cumulative perpetual securities containing specific provisions to write down the security or convert it to equity should the CET1 ratio fall to a defined trigger limit. Under transitional rules, securities that do not qualify in their own right but were issued and eligible as tier 1 capital prior to CRD IV can be partially included within AT1, until they are phased out altogether in 2022. To the extent these securities do not qualify as AT1 they may nevertheless still qualify as tier 2 capital.
- Tier 2 (T2) capital comprises certain other subordinated debt securities that do not qualify as AT1. They must have an original term of at least 5 years, cannot normally be redeemed within their first 5 years and are phased out as T2 regulatory capital in the final 5 years before maturity. Transitional rules under CRD IV allow securities that do not qualify in their own right as T2 capital, but which were issued and eligible as T2 capital prior to CRD IV, to be partially included as T2 capital until they are phased out altogether in 2022.

47 Capital (continued)

The Group's CRD IV transitional capital resources are summarised as follows:

	2015 £m	2014[1] £m
Common equity tier 1 capital	**8,765**	19,262
Additional tier 1 capital	**3,317**	2,419
Tier 2 capital	**3,290**	4,465
Total capital	**15,372**	26,146

[1]Restated – see note 1.

48 Cash flow statements

a Change in operating assets

	The Group	
	2015 £m	2014 £m
Change in loans and receivables	**3,456**	18,991
Change in amounts due from Group undertakings	**17,177**	145,137
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**18,354**	19,319
Change in other operating assets	**1,295**	1,287
Change in operating assets	**40,282**	184,734

b Change in operating liabilities

	The Group	
	2015 £m	2014[1] £m
Change in deposits from banks	**(751)**	(486)
Change in customer deposits	**(12,889)**	(3,631)
Change in amounts due to Group undertakings	**1,400**	(142,091)
Change in debt securities in issue	**(1,910)**	(9,047)
Change in derivative financial instruments and trading and other financial liabilities at fair value through profit or loss	**(17,378)**	(21,224)
Change in other operating liabilities	**(643)**	(3,433)
Change in operating liabilities	**(32,171)**	(179,912)

[1]Restated – see note 1.

48 Cash flow statements (continued)

c Non-cash and other items

	The Group	
	2015 £m	2014 £m
Depreciation and amortisation	**174**	179
Revaluation of investment properties	**(7)**	(7)
Allowance for loan losses	**215**	471
Write-off of allowance for loan losses, net of recoveries	**(2,920)**	(7,249)
Impairment of available-for-sale financial assets	**38**	8
Payment protection insurance provision	**1,102**	674
Other provision movements	**208**	315
Net charge (credit) in respect of defined benefit schemes	**121**	(199)
Unwind of discount on impairment allowances	**19**	(29)
Foreign exchange element on balance sheet[1]	**742**	761
Interest expense on subordinated liabilities	**429**	509
Loss (profit) on disposal of businesses	**–**	7
Other non-cash items	**(650)**	(271)
Total non-cash items	**(529)**	(4,831)
Contributions to defined benefit schemes	**(153)**	(193)
Payments in respect of other provision	**(193)**	(144)
Payments in respect of payment protection insurance provision	**(810)**	(740)
Other	**7**	27
Total other items	**(1,149)**	(1,050)
Non-cash and other items	**(1,678)**	(5,881)

[1]When considering the movement on each line of the balance sheet, the impact of foreign exchange rate movements is removed in order to show the underlying cash impact.

d Analysis of cash and cash equivalents as shown in the balance sheet

	The Group	
	2015 £m	2014 £m
Cash and balances with central banks	**2,481**	5,110
Less: mandatory reserve deposits[1]	**(452)**	(450)
	2,029	4,660
Loans and advances to banks	**691**	746
Less: amounts with a maturity of three months or more	**(328)**	(567)
	363	179
Total cash and cash equivalents	**2,392**	4,839

[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.

48 Cash flow statements (continued)

e Disposal and closure of group undertakings, joint ventures and associates

	The Group	
	2015 £m	2014 £m
Trading and other fair value financial assets through profit or loss	**–**	75
Loans and advances to customers	**–**	–
Loans and advances to banks	**–**	–
Investment property	**–**	–
Interest in joint ventures and associates	**22**	26
Goodwill	**–**	9
	22	110
Customer deposits	**–**	–
Debt securities in issue	**–**	–
Non-controlling interests	**–**	(12)
Other net assets (liabilities)	**–**	(15)
	–	(27)
Net assets	**22**	83
Profit (loss) on sale	**–**	(7)
Cash consideration received on losing control of group undertakings and businesses	**22**	76
Cash and cash equivalents disposed	**–**	–
Net cash inflow (outflow)	**22**	76

49 Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2015 and have not been applied in preparing these financial statements. Save as disclosed below, the full impact of these accounting changes is being assessed by the Group. As at 16 March 2016, these pronouncements are awaiting EU endorsement.

IFRS 9 Financial Instruments
IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. These changes are not expected to have a significant impact on the Group.

IFRS 9 also replaces the existing 'incurred loss' impairment approach with an expected credit loss approach, resulting in earlier recognition of credit losses. The IFRS 9 impairment model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2). The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology and involves quantitative measures, such as forward looking probabilities of default, and qualitative factors and therefore requires considerable management judgement. Stage 3 requires objective evidence of impairment which is similar to the guidance on incurred losses in IAS 39. IFRS 9 requires the use of more forward looking information including reasonable and supportable forecasts of future economic conditions. The need to consider multiple economic scenarios and how they could impact the loss allowance is a very subjective feature of the IFRS 9 impairment model. Loan commitments and financial guarantees not measured at fair value through profit or loss are also in scope.

These changes may result in a material increase in the Group's balance sheet provisions for credit losses although the extent of any increase will depend upon, amongst other things, the composition of the Group's lending portfolios and forecast economic conditions at the date of implementation. The requirement to transfer assets between stages and to incorporate forward looking data into the expected credit loss calculation, including multiple economic scenarios, is likely to result in impairment charges being more volatile when compared to the current IAS 39 impairment model.

The IFRS 9 expected credit loss model differs from the regulatory models in a number of ways, for example stage 2 assets under IFRS 9 carry a lifetime expected loss amount whereas regulatory models generate 12 month expected losses for non defaulted loans. In addition, different assets are in scope of each reporting base and therefore the size of the regulatory expected losses should not be taken as a proxy to the size of the loss allowance under IFRS 9.

In 2015, the Basel Committee on Banking Supervision published finalised guidance on credit risk and accounting for expected credit losses. The paper sets out supervisory guidance on how expected credit loss accounting models should interact with a bank's credit risk practices. The existing impairment processes, controls and governance will be reviewed and changed where necessary to reflect the increased demands of an expected credit loss impairment model.

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The accounting policy choice to continue with IAS 39 hedge accounting is still being considered by the Group.

49 Future accounting developments (continued)

The Group has an established IFRS 9 programme to ensure a high quality implementation in compliance with the standard and regulatory guidance. The programme involves Finance and Risk functions across the Group with Divisional and Group steering committees providing oversight. The key responsibilities of the programme include defining IFRS 9 methodology and accounting policy, identifying data and system requirements, and establishing an appropriate operating model and governance framework. The impairment workstreams have developed methodologies for many of the IFRS 9 requirements, although additional validation of these decisions will be on-going to reflect the uncertainty around regulatory and audit expectations. Some risk model build has started and detailed plans, including resource needs, are in place. We expect the majority of model build to be completed in 2016 to allow robust testing and the development of management information to take place in 2017.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018.

IFRS 15 Revenue from Contracts with Customers
IFRS 15 replaces IAS 18 Revenue and IAS 11 Construction Contracts. Financial instruments, leases and insurance contracts are out of scope and so this standard is not expected to have a significant impact on the Group.

IFRS 15 is effective for annual periods beginning on or after 1 January 2018.

IFRS 16 Leases
On 13 January 2016 the IASB issued IFRS 16 to replace IAS 17 Leases. IFRS 16 requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessor accounting requirements remain aligned to the current approach under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019.

Amendments to IAS 7 Statement of Cash Flows and IAS 12 Income Taxes
In January 2016, the IASB issued amendments to IAS 7 Statement of Cash Flows which require additional disclosure about an entity's financing activities and IAS 12 Income Taxes which clarify when a deferred tax asset should be recognised for unrealised losses. These revised requirements, which are effective for annual periods beginning on or after 1 January 2017, are not expected to have a significant impact on the Group.

50 Other information

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.

Group companies

GROUP COMPANIES

In compliance with Section 409 of the Companies Act 2006, the following comprises a list of all related undertakings of the Group, as at 31 December 2015. The list includes each undertaking's country of incorporation (UK unless otherwise stated) and the percentage of class(es) of shares held by the immediate parent company. Where different, the ultimate percentage held by the Group is given in brackets. All shares are ordinary shares indirectly held by HBOS plc unless indicated otherwise.

Subsidiary undertakings

The Group holds a majority of voting rights of the following undertakings.

Name of Undertaking	% of class held by immediate parent company	
ADF No.1 Pty Ltd, (Australia)	100%	
Anglo Scottish Utilities Partnership 1	n/a	*
Automobile Association Personal Finance Limited	100%	
Bank Of Scotland (Stanlife) London Nominees Limited	n/a	*
Bank Of Scotland Branch Nominees Limited	100%	
Bank Of Scotland Capital Funding (Jersey) Limited, (Jersey)	100%	
Bank Of Scotland Central Nominees Limited	n/a	*
Bank Of Scotland Edinburgh Nominees Limited	n/a	*
Bank Of Scotland Equipment Finance Limited	100%	
Bank Of Scotland Hong Kong Nominees Limited, (Hong Kong)	n/a	*
Bank Of Scotland Insurance Services Limited	99.99% (100%)	
Bank Of Scotland Leasing Limited	100%	
Bank Of Scotland LNG Leasing (No 1) Limited	100%	
Bank Of Scotland London Nominees Limited	n/a	*
Bank Of Scotland Nominees (Unit Trusts) Limited	n/a	*
Bank Of Scotland P.E.P. Nominees Limited	n/a	*
Bank of Scotland plc	99.99% (100%)	^
Bank Of Scotland Structured Asset Finance Limited	100%	
Bank Of Scotland Transport Finance 1 Limited	100%	
Bank Of Wales Limited	100%	
Barents Leasing Limited	100%	
Bavarian Mortgages No. 5 Limited	99.99% (100%)	
Bavarian Mortgages No.2 Limited (In Liquidation)	100%	
Birmingham Midshires Asset Management Limited	100%	
Birmingham Midshires Financial Services Limited	100%	
Birmingham Midshires Land Development Limited	100%	
Birmingham Midshires Mortgage Services Limited	100%	
Birmingham Midshires Mortgage Services No.1 Limited	100%	
Birmingham Midshires Property Services Limited (In Liquidation)	100%	
	100%	vi
BOS (Boston) Inc, (USA)	100%	
BOS (Ireland) Nominees Limited, (Ireland)	100%	
BOS (Ireland) Property Services 2 Limited, (Ireland)	100%	
BOS (PB) LLC, (USA)	100%	
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Limited	100%	
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Limited	100%	
BOS (Shared Appreciation Mortgages (Scotland)) Limited	100%	
BOS (Shared Appreciation Mortgages) No. 1 Plc	99.99% (100%)	
BOS (Shared Appreciation Mortgages) No. 2 Plc	99.99% (100%)	
BOS (Shared Appreciation Mortgages) No. 3 Plc	99.99% (100%)	
BOS (Shared Appreciation Mortgages) No. 4 Plc	99.99% (100%)	
BOS (Shared Appreciation Mortgages) No. 5 Plc	99.99% (100%)	
BOS (Shared Appreciation Mortgages) No. 6 Plc	99.99% (100%)	
BOS (Southport) Holding LLC, (USA)	100%	
BOS (USA) AI Inc., (USA)	100%	
BOS (USA) Fund Investments Inc., (USA)	100%	
BOS (USA) Inc, (USA)	100%	
BOS Aircraft Holdings Limited (In Liquidation)	100%	
BOS Edinburgh No 1 Limited	100%	
BOS Mistral Limited	100%	
BOSIC Inc, (Canada)	100%	
BOSSAF Rail Limited	100%	
Britannia Personal Lending Limited	100%	i
British Linen Leasing (London) Limited	100%	
British Linen Leasing Limited	100%	
British Linen Shipping Limited	100%	
Brooklyn Properties Limited, (Ireland)	100%	i
	100%	ii
Capital 1945 Limited	100%	
Capital Bank Insurance Services Limited	100%	
Capital Bank Leasing 1 Limited	100%	
Capital Bank Leasing 10 Limited	100%	
Capital Bank Leasing 11 Limited	100%	
Capital Bank Leasing 12 Limited	100%	
Capital Bank Leasing 2 Limited	100%	
Capital Bank Leasing 3 Limited	100%	
Capital Bank Leasing 4 Limited	100%	
Capital Bank Leasing 5 Limited	100%	
Capital Bank Leasing 6 Limited	100%	
Capital Bank Leasing 7 Limited	100%	
Capital Bank Leasing 8 Limited	100%	
Capital Bank Leasing 9 Limited	100%	
Capital Bank Property Investments (3) Limited	100%	
Capital Bank Property Investments (6) Limited	100%	
Capital Bank Vehicle Management Limited	100%	

Group companies

Capital Leasing (Edinburgh) Limited	100%	
Capital Leasing Limited	100%	
Capital Personal Finance Limited	100%	
Cartwright Finance Limited	100%	iv, #
	0.08%	iii
Castlemill Investments Limited (In Liquidation)	100%	
CBRail Limited (In Liquidation)	100%	
CBRail S.A.R.L., (Luxembourg)	100%	
CF Asset Finance Limited	100%	
Chariot Finance Limited	100%	
County Wide Property Investments Limited	100%	
Deva Lease 2 Limited	100%	
Deva Lease 3 Limited	100%	
First Alternative Limited	100%	^
First Retail Finance (Chester) Limited	100%	
Flexifly Limited	100%	
Forthright Finance Limited	100%	
Fortrose Investments Limited (In Liquidation)	100%	
Freeway Limited	100%	
General Insurance Services Limited	100%	^
Gensar Design Limited (In Liquidation)	100%	
GFP Holdings LLC, (USA)	100%	
Gleacher Mezzanine LLC, (USA)	100%	
Glosstrips Limited	100%	
Godfrey Davis (Contract Hire) Limited	100%	
Halifax Credit Card Limited	100%	i
	100%	ii
	100%	iii
Halifax Group Limited	100%	^
Halifax Leasing (June) Limited	100%	
Halifax Leasing (March No.2) Limited	100%	
Halifax Leasing (September) Limited	100%	
Halifax Limited	100%	^
Halifax Loans Limited	100%	
Halifax Mortgage Services (Holdings) Limited	100%	
Halifax Mortgage Services Limited	100%	
Halifax Nominees Limited	100%	
Halifax Pensions Nominees Limited	100%	
Halifax Premises Limited	100%	
Halifax Share Dealing Limited	100%	^
Halifax Vehicle Leasing (1998) Limited	100%	
HBOS Canada Inc, (Canada)	100%	
HBOS Covered Bonds LLP	n/a	*
HBOS Directors Limited	100%	
HBOS Final Salary Trust Limited	100%	^
HBOS Management (Jersey) Limited (Jersey)	100%	^
HBOS Social Housing Covered Bonds LLP	n/a	*
HBOS Treasury Services Limited	100%	
HBOS UK Limited	100%	^
HL Group (Holdings) Limited	100%	
Home Shopping Personal Finance Limited	100%	
Horizon Capital 2000 Limited	100%	
Horizon Capital Limited	100%	
Horizon Hotel Investments Limited	100%	
Horizon Property Investments Limited	100%	
Horizon Residential Developments Limited (In Liquidation)	100%	
Horizon Resources Limited	100%	
Housing Growth Partnership LP	n/a	*
HSDL Nominees Limited	100%	
IBOS Finance Limited	100%	
IBOS Securities	n/a	*
ICC Enterprise Partners Limited, (Ireland)	100%	
ICC Equity Partners Limited, (Ireland)	100%	
ICC ESOP Trustee Limited, (Ireland)	100%	
ICC Holdings, (Ireland)	99.09% (100%)	
ICC Software Partners Limited, (Ireland)	100%	
IF Covered Bonds Limited Liability Partnership	n/a	*
In Store Credit Limited	100%	
Intelligent Finance Financial Services Limited	100%	
Intelligent Finance Software Limited	100%	
IWEB (UK) Limited (In Liquidation)	100%	
Kanto Leasing Limited	100%	
Katrine Leasing Limited, (Jersey)	100%	
Kripton Properties Limited (In Liquidation), (Ireland)	100%	
Legacy Renewal Company Limited	99.99% (100%)	
Lex Vehicle Finance Limited	100%	
Lex Vehicle Leasing (Holdings) Limited	100%	i
	100%	ii
	100%	v
Lex Vehicle Leasing Limited	100%	
Lex Vehicle Partners (1) Limited	100%	
Lex Vehicle Partners (2) Limited	100%	
Lex Vehicle Partners (3) Limited	100%	

Group companies

Lex Vehicle Partners (4) Limited	100%	
Lex Vehicle Partners Limited	100%	
Lloyds Bank (Fountainbridge 1) Limited	100%	
Lloyds Bank (Fountainbridge 2) Limited	100%	
Lloyds Banking Group Insurance PCC Limited (In Liquidation), (Guernsey)	77.16%	
Lloyds Secretaries Limited	100%	
London Uberior (L.A.S.Group) Nominees Limited	n/a	*
Meadowfield Investments Limited	100%	
Membership Services Finance Limited	100%	
Moray Investments Limited	100%	
Mortgage Services Funding Limited (In Liquidation)	100%	
Nevis Leasing Limited, (Jersey)	74%	
NFU Mutual Finance Limited	100%	i, #
	100%	iii
Nordic Leasing Limited	100%	
Northern Mortgage Corporation Limited (In Liquidation)	100%	
NWS 2	n/a	*
NWS Trust Limited	100%	
Ocean Leasing (July) Limited	100%	
Ocean Leasing (No 1) Limited	100%	
Ocean Leasing (No 2) Limited	100%	
Omnistone Limited, (Ireland)	100%	i
	100%	ii
	98% (100%)	iii
Pacific Leasing Limited	100%	
Peony Eastern Leasing Limited	100%	
Peony Leasing Limited	100%	
Peony Western Leasing Limited	100%	
Prestonfield Investments Limited	100%	
Prestonfield P1 Limited	100%	
Prestonfield P2 Limited	100%	
Prestonfield P3 Limited	100%	
Quion 6 BV, (Netherlands)	100%	
Saleslease Purchase Limited	100%	
Scotland International Finance No. 2 B.V., (Netherlands)	100%	
Scotmar Commercial Equipment Finance Limited	100%	i, #
Seabreeze Leasing Limited	100%	
Seadance Leasing Limited	100%	
Seaforth Maritime (Highlander) Limited	100%	
Seaforth Maritime (Jarl) Limited	100%	
Seaspirit Leasing Limited	100%	
Seaspray Leasing Limited	100%	
Share Dealing Nominees Limited	100%	
Shidben Dale Limited	100%	
Standard Property Investment (1987) Limited	0% (100%)	i
	100%	ii
Standard Property Investment Limited	60.34%	
Sussex County Homes Limited	100%	
Tantallon Investments, Inc	100%	
The British Linen Company Limited	99.98%	
The Mortgage Business Public Limited Company	99.99% (100%)	
Thistle Leasing	n/a	*
Tower Hill Property Investments (10) Limited	90%	
Tower Hill Property Investments (7) Limited	90%	
Tranquility Leasing	100%	
Uberior (Moorfield) Limited	100%	
Uberior Canada LP Ltd, (Canada)	100%	
Uberior Co-Investments Limited	100%	
Uberior ENA Limited	100%	
Uberior Equity Limited	100%	
Uberior Europe Limited	100%	
Uberior Fund Investments Limited	100%	
Uberior Infrastructure Investments (No 2) Limited	100%	
Uberior Infrastructure Investments Limited	100%	
Uberior Investments Limited	99% (100%)	
Uberior ISAF CIP 2007 L.P	n/a	*
Uberior Nominees Limited	n/a	*
Uberior Trading Limited	99% (100%)	
Uberior Trustees Limited	n/a	*
Uberior Ventures Australia Pty Limited, (Australia)	100%	
Uberior Ventures Limited	100%	
Vehicle Leasing (1) Limited	100%	
Vehicle Leasing (2) Limited	100%	
Vehicle Leasing (4) Limited	100%	
Warwick Leasing Limited	100%	i
	100%	ii
West Craigs Limited	100%	
Western Trust & Savings Holdings Limited	100%	
Western Trust Holdings Limited	100%	

^ Shares held directly by HBOS plc
* The undertaking does not have share capital
# An undertaking external to the Group holds a separate class of share
(i) A Ordinary shares
(ii) B Ordinary shares
(iii) C Ordinary shares
(iv) N Ordinary shares
(v) Redeemable preference shares
(vi) Redeemable ordinary shares

Group companies

Subsidiary Undertakings[(i)]

Name of Undertaking
Addison Social Housing Holdings Limited, (Jersey)
Addison Social Housing Limited
Candide Financing 2006 BV, (Netherlands)
Candide Financing 2007 NHG BV, (Netherlands)
Candide Financing 2008-1 BV, (Netherlands)
Candide Financing 2008-2 BV, (Netherlands)
Candide Financing 2011-1 BV, (Netherlands)
Candide Financing 2012-1 BV, (Netherlands)
Craig Finance Limited
Craig Financing Holdings Limited
Deva Financing Holdings Limited
Deva Financing plc
Edgbaston RMBS 2010-1 plc
Edgbaston RMBS Holdings Limited
Headingley RMBS 2011-1 Holdings Limited
Headingley RMBS 2011-1 plc
Leicester Securities 2014 Limited, (Ireland)
Lingfield 2014 I Holdings Limited
Lingfield 2014 I plc
Mound Holdings Limited
Mound Holdings No.2 Limited
Penarth Asset Securitisation Holdings Limited
Penarth Funding 1 Limited, (Jersey)
Penarth Funding 2 Limited, (Jersey)
Penarth Master Issuer plc
Penarth Receivables Trustee Limited, (Jersey)
Permanent Funding (No. 1) Limited
Permanent Funding (No. 2) Limited
Permanent Holdings Limited
Permanent Master Issuer plc
Permanent Mortgages Trustee Limited, (Jersey)
Permanent PECOH Holdings Limited
Permanent PECOH Limited
Trinity Financing Holdings Limited
Trinity Financing plc
Trinity Holdings Limited
Wolfhound Funding 2 Limited, (Ireland)
Wolfhound Funding 2008-1 Limited, (Ireland)

(i) The Group has determined that it has the power to exercise control without having majority of the voting rights of the undertakings. Unless otherwise stated, the undertakings do not have a share capital or the Group does not hold any shares.

Group companies

Associated Undertakings

The Group has a participating interest in the following undertakings:

Name of Undertaking	% of class held by immediate parent company
A G Germany Limited	100% v
Agora Shopping Centres Limited (In Administration)	50% ii
Alderley Capital Limited (In Administration) (Isle of Man)	50% ii
Aspire Oil Services Limited	23.67%
Australand Apartments No.6 Pty Ltd, (Australia)	50%
Australand Residential Trust, (Australia)	n/a *
AVJBOS Nominees Proprietary Limited, (Australia)	50%
Bergamot Ventures Limited	50% ii
Business Growth Fund Plc	23%
Capital Gardens Limited	30.5%
Cary Towne Parke Holdings LLC, (USA)	98%
Cary Towne Parke LLC, (USA)	98%
City & General Securities Limited	32.7%
Connery Limited, (Jersey)	20%
Continental Shelf 225 Limited (In Liquidation)	49% i
Continental Shelf 291 Limited (In Liquidation)	40.09% i
D.U.K.E Real Estate Limited	50% ii
DCK Group Limited	75% vi
Europa Property Company (Northern) Limited	35%
European Property Fund (Holdings) Limited SARL, (Luxembourg)	24.9%
Fern Bay Seaside Village Limited (In Liquidation), (Australia)	34.48%
FHR European Ventures LLP	n/a *
Golfview Apartment Holdings LLC, (USA)	88%
Golfview Apartments LLC, (USA)	88%
HBOS Sterling Finance (Jersey) LP, (Jersey)	n/a *
Hillview (Watford) Limited	50%
Injection Directe Immobilier SAS, (France)	48%
Kenmore Capital 2 Limited (In Liquidation)	50% ii
Kenmore Capital 3 Limited (In Administrative Receivership)	50% ii
Kenmore Capital Limited (In Liquidation)	50% ii
Lighthouse Healthcare Group Limited	41.6%
Lothian Fifty (150) Limited	47.50%
Morston Assets Limited (In Administration)	20%
Motability Operations Group plc	20% (40%)
	20% (40%) iii
Murray International Holdings Limited (In Liquidation)	30%
	100% iii
Northern Edge Limited	23.27%
Octagon (Richmond) Limited	50% ii
PIHL Equity Administration Limited	35% ii
Prestbury 1 Limited Partnership	n/a *
Prestbury Hotel Holdings Limited (In Liquidation)	27.50% v
Prestbury Wentworth Holdings Limited (In Liquidation)	29.41% v
Sapphire Retail Fund Limited (In Liquidation)	50% ii
Secure Income REIT Plc	23.64%
Southport Green Acquisition LLC, (USA)	50%
Stainton Capital Holdings Limited (In Liquidation)	50%
Stewart Milne (Glasgow) Limited	100% i
Stewart Milne (West) Limited	100% i
Tantallon Acquisition LLC, (USA)	100%
Tantallon Austin Hotel LLC, (USA)	100%
Tantallon Austin LLC, (USA)	100%
Tantallon LLC, (USA)	75%
Tantallon Orlando LLC, (USA)	100%
The Scottish Agricultural Securities Corporation P.L.C.	33.33%
Thread Real Estate Cary Towne Park LLC, (USA)	50%
Thread Real Estate Golfview LLC, (USA)	50%
Valad Canadian Partners LP, (Canada)	n/a *
Whitefleet Limited (In Liquidation)	100% i
Zog Brownfield Ventures Limited (In Administration)	50%

* The undertaking does not have share capital
(i) A Ordinary Shares
(ii) B Ordinary Shares
(iii) Preferences Shares
(iv) Investor Preference Shares
(v) C Ordinary Shares
(vi) F Ordinary Shares

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