Lloyds Bank Corporate Markets plc

Report and Accounts
2021

Member of Lloyds Banking Group

Contents

Strategic report

The directors present their Strategic report on Lloyds Bank Corporate Markets plc (the Bank) and its subsidiary undertakings (together, the Group) for the year ended 31 December 2021.

The Bank and the Group provide a wide range of banking and financial services through branches and offices in the UK, the Crown Dependencies, the USA, Singapore and Germany. The Bank was established in response to the Financial Services (Banking Reform) Act 2013 for the purpose of carrying on elements of the commercial banking business of Lloyds Banking Group plc (also referred to herein as LBG) along with the banking business of LBG in territories outside the EEA. The Group contributes to the financial results of the Commercial Banking Division of LBG.

Principal activities

The Group supports a diverse range of customers and provides a broad range of banking products to help them achieve their financial goals. The Group's revenues are earned through the provision of financing and risk management solutions to commercial customers; and current accounts, savings accounts, mortgages, car finance and personal loans in the Retail market in our Crown Dependencies businesses.

The target market for these products and services in the UK and internationally is made up of large corporates, financial institutions and commercial customers plus, in the Crown Dependencies, retail customers and includes the following product propositions:

– Commercial lending (including fixed rate loans, revolving credit facilities, variable loans and business mortgages)
– Trade and working capital management (including trade services, trade finance, supply chain finance and asset finance)
– Bonds and structured finance (including bonds, structured lending and asset securitisation)
– Risk management (including Foreign Exchange, rates, credit, commodities and liabilities management)
– Retail banking services (including mortgages, personal current accounts, personal loans and motor finance) in the Crown Dependencies
– ESG product solutions (including green bonds and sustainability-linked loans)

Strategy and future developments

Following a strategic review, the Group's purpose of Helping Britain Prosper has been re-affirmed and forms the basis of our new strategy as part of LBG. Core to that purpose and strategy is our focus on building an inclusive society and supporting the transition to a low carbon economy. The Group will continue to connect the UK and LBG with the world through a first-class banking, financing and risk management proposition, underpinned by excellent customer service. The Group will build on our areas of strongest expertise including:

– Growing our presence in risk management by enhancing our product offering and increasing market share; and building our debt capital markets franchise
– Deepening our footprint in North America
– Increasing deposit capability and our customer base in our Crown Dependencies business

The Group will focus on opportunities that are highly aligned to our purpose and where we have competitive advantage. As such, the Group will concentrate our investment in the core businesses where it can unlock profitable growth. In view of this, it has been decided that our branch in Singapore will close in 2022. Investment will take place in platforms, digitisation and new product propositions; as well as our people and the front office teams in growth businesses.

Business review

Key to the success of the Group's strategy is the focus on delighting our customers and success is measured via customer-focussed objectives such as customer satisfaction and complaint levels monitored through a range of customer insight and feedback. Our ongoing commitment to treat customers fairly and consistently delivering great service is central to our ways of working. Our customer focused business model continues to provide a competitive advantage with the diversity and strength of our client franchise enabling scalable business propositions, relative cost efficiencies and sustainable returns on capital deployed. We are developing a culture to attract, retain and develop the right capability for the future. The Group has a high quality balance sheet, and is Helping Britain Prosper through a simple digitised business underpinned by a strong brand, credit rating and capital position. The shared service model we utilise leverages LBG capabilities to meet the needs of our customers and we are transforming the business to deliver a leading customer experience.

The Bank's Board of Directors (the Board) regularly monitors business performance, appropriate levels of capital, funding and liquidity, and delighting our customers. The Board notes the following with regard to strategic process and indicators of performance:

– Completion of the strategic review
– Appropriate levels of capital, liquidity and funding have been maintained and metrics are noted on page 3; and development of the funding structure to build resilience
– Continued support and assistance provided to our customers through the tough times and disruption of the COVID-19 pandemic
– Launched a clean growth financing initiative in our Crown Dependencies business and executed 15 public bond transactions for the social housing sector
– The seamless continuity of operations across our business both in the UK and Internationally as colleagues worked through multiple lockdowns and the transition to a hybrid working model (both within the Group and our shared service provider teams)
– The wellbeing of team members throughout our businesses with continuing measures taken to ensure our branch-based customer facing colleagues were able to operate in a safe way plus the ongoing provision of IT and other equipment to facilitate office-based colleagues working from home
– Colleague development, learning hours and engagement measured through our annual survey
– Progress on digitisation of our markets business in FX and Rates products, as well as build out of platform capability in the Crown Dependencies
– Significant progress on IBOR transition including delivery of the required core changes to technology and processes for year end

Financial performance

Overall, in 2021 the Group recorded an improved financial performance compared to the prior year with net interest income improved through stable funding and discipline in the management of margin and returns; impairment income from the release of expected credit loss (ECL) provisions no longer required and diligent management of costs. Regulatory capital adequacy remains strong with a common equity tier 1 (CET1) capital ratio of 13.1 per cent, reflecting the stability of the business and strength of the Group's client franchise.

Income statement

During the year ended 31 December 2021, the Group recorded a profit before tax of £289 million significantly higher than the profit before tax of £45 million in 2020.

Total income was £641 million compared to £544 million in 2020, comprising net interest income of £187 million compared to £74 million in 2020, net fee and commission income of £221 million compared to £191 million in 2020, net trading income of £244 million compared to £279 million in 2020, and other operating expenses of £11 million compared to £nil in 2020. Net interest income has benefitted from stable funding markets during 2021 and management action to build resilience. Net fee and commission income has performed well year-on-year whilst net trading income is lower than 2020 due to limited underlying market volatility. Other operating expenses relate to one-off losses on strategically exited positions.

Operating expenses were £414 million compared to £428 million in 2020, predominantly consisting of management charges relating to the Intra Group Agreement (IGA) and staff costs payable to Lloyds Bank plc. This represents a reduction of £14 million as a result of management actions and specific cost control initiatives.

The Group has recognised an impairment credit of £62 million compared to an impairment expense of £71 million in 2020 relating to the unwind of ECL from an improving economic outlook. There have been no significant new credit impaired cases (stage 3 impairment) in the year.

The Group recorded a tax expense of £51 million compared to £1 million in 2020 reflecting higher profitability in 2021.

Balance sheet

Total assets of the Group were £88,699 million at 31 December 2021, £3,730 million lower than the assets at 31 December 2020 of £92,429 million. The largest movement is in derivative financial instruments assets which decreased in the year by £3,767 million to £17,990 million compared to £21,757 million at 31 December 2020 mainly due to fair value movements driven by interest rate increasing in most major markets.

Cash and balances at central banks decreased by £1,229 million from £23,369 million at 31 December 2020 to £22,140 million at 31 December 2021 driven by the reduction in the liquidity required. Financial assets at fair value through profit or loss increased in the year by £1,483 million to £22,409 million compared to £20,926 million at 31 December 2020 driven by increases in reverse repurchase agreements. Financial assets at amortised cost increased to £25,616 million compared to £25,087 million at 31 December 2020, which includes loans and advances to customers of £17,432 million compared to £14,256 million at 31 December 2020 due to targeted growth in lending and higher facility utilisation.

Total liabilities of the Group were £85,210 million at 31 December 2021 compared to £88,800 million at 31 December 2020.

Deposits from Banks of £3,821 million decreased by £1,780 million reducing from £5,601 million at 31 December 2020; and customer deposits of £26,967 million increased by £1,470 million from £25,497 million at 31 December 2020. Financial liabilities at fair value through profit or loss of £16,582 million increased by £767 million compared to £15,815 million at 31 December 2020 and mainly consist of repurchase agreements. Derivative financial instruments liabilities of £15,572 million compared to £21,233 million at 31 December 2020 decreased by £5,661 million mainly as a result of an increase in market yield curves.

Debt securities in issue of £16,644 million increased in the year by £1,042 million compared to £15,602 million at 31 December 2020 mainly due to new issuances during 2021 of commercial paper.

Total equity at the year-end was £3,489 million compared to £3,629 million at 31 December 2020. This movement largely reflects that during the year the Board approved the payment of an interim dividend of £200 million to the Group's parent company, LBG.

Capital

The Bank's common equity tier 1 (CET1) capital ratio reduced to 13.1 per cent (31 December 2020: 14.8 per cent) and the tier 1 capital ratio reduced to 17.2 per cent (31 December 2020: 19.4 per cent), following the accrual for foreseeable dividends and the increase in risk-weighted assets, offset in part by profits for the year.

The total capital ratio reduced to 20.1 per cent (31 December 2020: 22.5 per cent) following the increase in risk-weighted assets and the reduction in tier 1 capital.

Risk-weighted assets increased by £1,826 million, or 11.0 per cent, to £18,436 million at 31 December 2021, compared to £16,610 million at 31 December 2020, largely reflecting increased lending to customers and an increase in market risk related to IBOR transition activities.

On 1 January 2022 the Bank implemented a new standardised approach for measuring counterparty credit risk (SA-CCR) as part of the implementation of the remainder of CRR II, the impact of which was an increase in counterparty credit risk and credit valuation adjustment risk, risk-weighted assets of £1.8 billion.

Capital position at 31 December 2021

The capital position of Lloyds Bank Corporate Markets plc is presented on an unconsolidated basis.

The Bank's capital position as at 31 December 2021 is set out in the following section.

Capital resources of the Bank	At 31 Dec 2021 £m	At 31 Dec 2020 £m
Common equity tier 1		
Shareholders' equity per balance sheet	**2,783**	2,914
Adjustment to retained earnings for foreseeable dividends	**(220)**	(200)
Cash flow hedging reserve	**48**	(105)
Debit valuation adjustment	**(16)**	(25)
Other adjustments	**—**	34
	2,595	2,618
less: deductions from common equity tier 1		
Prudent valuation adjustment	**(163)**	(156)
Excess of expected losses over impairment provisions and value adjustments	**(9)**	—
Common equity tier 1 capital	**2,423**	2,462
Additional tier 1		
Additional tier 1 instruments	**757**	757
Total tier 1 capital	**3,180**	3,219
Tier 2		
Tier 2 instruments	**633**	635
Other adjustments	**(104)**	(109)
Total tier 2 capital	**529**	526
Total capital resources	**3,709**	3,745
Risk-weighted assets of the Bank (unaudited)	**18,436**	16,610
Capital ratios of the Bank (unaudited)		
Common equity tier 1 capital ratio	**13.1%**	14.8%
Tier 1 capital ratio	**17.2%**	19.4%
Total capital ratio	**20.1%**	22.5%

Risk-weighted assets of the Bank (unaudited)	At 31 Dec 2021 £m	At 31 Dec 2020 £m
Foundation Internal Ratings Based (IRB) Approach	**7,665**	6,566
Other IRB Approach	**206**	267
IRB Approach	**7,871**	6,833
Standardised Approach	**1,601**	1,961
Credit risk	**9,472**	8,794
Counterparty credit risk	**4,149**	3,948
Credit valuation adjustment risk	**472**	324
Operational risk	**855**	952
Market risk	**2,933**	1,982
Underlying risk-weighted assets	**17,881**	16,000
Threshold risk-weighted assets[1]	**555**	610
Total risk-weighted assets	**18,436**	16,610

1 Threshold risk-weighted assets reflect the element of deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital.

Section 172(1) statement and statement of engagement with employees and other stakeholders

In accordance with the Companies Act 2006 (the Act) (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the directors provide the following statement describing how they have had regard to the matters set out in section 172(1) of the Act, when performing their duty to promote the success of the Bank under section 172. Further details on key actions in this regard are also contained within the Directors' report on page 14 and the Corporate Governance Report on pages 14 to 16.

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the following statement also provides details of how the directors have engaged with and had regard to the interests of key stakeholders. The Bank is a subsidiary of LBG, and as such adopts many of the processes and practices of LBG, which are further referred to in this statement where relevant.

The directors acknowledge that one of the primary responsibilities of the Board is to ensure the strategy of the Bank, as aligned to that of LBG, achieves long-term success and generates sustainable returns, central to which is ensuring engagement with stakeholders, and considering in all instances the long-term implications of decisions made, acting at all times to maintain the highest possible standards of conduct. This year interaction with stakeholders continued to be adapted to comply with the UK Government's measures in relation to COVID-19 and has been undertaken virtually as necessary.

Customers

The Board's deep understanding of customers' needs is vital in setting and achieving the Bank's goals. Delighting our customers and identifying their needs through a customer-centric approach remains therefore a key consideration in Board decisions.

The directors ensure the Bank works towards achieving its customers' ambitions, treating customers fairly, and making it easy for customers to find, understand and access products that are suitable for their needs. The Board is committed to providing meaningful support to meet the needs of customers, aiming to provide positive outcomes, and working to mitigate or reduce the risk of financial harm. In particular, the Board is mindful of helping customers to recover from a challenging period during the pandemic.

To ensure directors truly understand the needs of customers, customer feedback and related management information is regularly considered including as part of the directors' strategic decision-making process. The Bank proactively engages with customers by conducting customer feedback surveys, including the Client 360 Feedback Programmes, bespoke 'in the moment' feedback and Greenwich surveys. The Board exercises oversight of customer satisfaction through updates from the output of these surveys and the level of complaints within the business.

The Bank regularly benchmarks its performance and the performance of its business units amongst its customers. The directors use this insight along with a range of internal and external research to ensure ongoing improvement in customer experience. The directors ensure the Bank plays an active part in LBG's wider customer ambitions, as acknowledged in the Bank's strategy, and where appropriate during the course of the year this has included the ongoing development of market leading digital propositions, more personalised customer propositions and better experience for customers across all channels.

Shareholders

The Bank is a wholly owned subsidiary of LBG, forming part of its Commercial Banking Division. As a wholly owned subsidiary, the Board ensures that the strategy, priorities, processes and practices of the Group are aligned where appropriate to those of LBG, ensuring that its interests as the Bank's shareholder are duly acknowledged. The Bank's Corporate Governance Framework sets out the Bank's relationship with LBG and the reporting of material matters.

The LBCM Board and its Committees provide regular updates to the LBG Board and its committees on the Bank's activities and performance. The LBG Chief Executive and LBG Chair are invited to attend at least one Bank Board meeting each year to hold an open discussion on such matters as the Bank's strategy in the context of LBG and the operation of the shared service model. LBG's Non-Executive Directors are also invited to attend Board and Committee meetings during the year at which the Board can share insights and hear the LBG perspective increasing shareholder engagement. These arrangements ensure the Bank's Board has a clear understanding of the views of its shareholder.

Further information in respect of the relationship of LBG with its shareholders is included on page 27 of Strategic Report within the Lloyds Banking Group Annual Report and Accounts for 2021, available on the Lloyds Banking Group website.

Colleagues

The Board considers that maintaining open dialogue is crucial in informing its thinking, allowing directors to hear first-hand colleague views on the matters most important to them, and to the Group. Throughout 2021 the Board received regular updates on workforce[1] engagement and on colleague matters generally including key themes raised by colleagues and trends on people matters, including for example absence (and in particular attrition), the Group's continuing response to the COVID-19 pandemic and our future ways of working. The Board's focus on colleague matters has included engagement, culture, succession and people risks.

The Board's engagement with colleagues remained restricted and of a virtual nature as a result of the COVID-19 pandemic and LBG guidance for colleagues working remotely. Board visits to our offices across our jurisdictions were therefore conducted remotely. In addition, the Board continued to engage with the senior management team for ad hoc conversations outside of regular Board activity and held a series of Board and colleague virtual breakfasts events, allowing for open two-way dialogue with colleagues from across the different business areas and jurisdictions on a range of topics including ESG and resilience. To support business as usual activity, Board members have delivered stand-alone communications; a highlight being a call hosted by the Chair and Chief Executive to celebrate the three-year anniversary since stand-up of the Bank in 2018 highlighting its key achievements. COVID-19 restrictions permitting, Board members took the opportunity to visit a number of business areas to speak directly with colleagues to learn more about the business first-hand, hear about their concerns and discuss new ways of working. The Board was supportive of LBG's new Chief Executive visit to our London office trading floor where he spent time meeting colleagues and looking at our operations. The Chair put the idea forward for a new monthly award for colleagues making a significant difference in delighting customers and reducing bureaucracy and is proactively engaged in congratulating the winners.

During the year, the Board gained further understanding of colleague views through a number of surveys completed by colleagues across the Group. These included the annual colleague survey, ad hoc 'Pulse' surveys, and participation by colleagues in the external survey of the Financial Services Culture Board. The Board continues to be updated on the actions arising out of the surveys.

The directors consider these arrangements invaluable in giving them an understanding of the views of the workforce and encouraging meaningful dialogue between the Board and the workforce.

During the year, the Group also communicated directly with colleagues detailing its performance and that of LBG, changes in the economic and regulatory environment, and updates on key strategic initiatives. The Board was especially mindful of the impacts on colleagues of the strategic changes made during 2020 which continued to be felt during the year, in particular in the Crown Dependencies and the USA, ensuring colleagues received ongoing support throughout the process.

Our colleagues are remunerated by LBG (and recharged to the Group). UK colleagues are eligible to participate in HMRC approved share plans which promote share ownership by giving employees an opportunity to invest in LBG shares. Given improved LBG performance in 2021, the LBG Remuneration Committee approved Group Performance Share awards for colleagues. Colleagues are remunerated by LBG, and UK and US colleagues are eligible to participate in HMRC/IRAS approved share plans which promote share ownership by giving employees an opportunity to invest in LBG shares. Further information can be found in the Directors' Remuneration Report within the LBG Annual Report and Accounts for 2021, available on the LBG website.

During 2021, the Bank has continued to provide essential financial services to its customers by implementing business changes to manage the pandemic and have reviewed every iteration of the Government advice in the UK and local advice across the jurisdictions in which it operates. There has been significant continuity for most colleagues in terms of working arrangements from 2020, although colleagues have started to return to the workplace from November 2021, in line with the new ways of working set out by the Group.

Colleagues are vital to the delivery of the Group's strategy and ambitions. This is recognised by the Board in its engagement with colleagues throughout the year. Whilst the COVID-19 pandemic has been challenging for our customers, it has also continued to pose challenges for our colleagues. The Board has remained keen to ensure colleagues receive all the support the Group can give. The Chief Executive has continued to keep the Board updated on pertinent COVID-19 issues impacting the Group and the wider external environment where the Board could provide support to the Chief Executive's initiatives. Regular engagement has continued throughout the pandemic. Regular and open engagement with colleagues has been crucial, with the Chief Executive undertaking a series of updates and calls to keep colleagues informed of developments as they have changed and the transition to new ways of working.

Looking forward, the Board has been updated on the adoption of Group's future workstyles and has seen increased numbers of colleagues returning to the office. The Board has ensured that the workforce has been supported with this transition and has continued to monitor the approach and encouraged colleagues to retain good habits built up during the pandemic as they transition back to their offices.

In support of colleagues, Speak Up (LBG's whistleblowing programme) enables colleagues to raise matters of concern. Andrew McIntyre is the Bank and Group's Whistleblowing Champion and is responsible for overseeing the integrity, independence and effectiveness of LBG's whistleblowing procedures for the Bank and Group. The Audit Committee receives reports on whistleblowing to ensure there are arrangements in place which colleagues can use in confidence to report relevant concerns.

1 The definition of 'workforce' as agreed by the Board is permanent employees, contingent workers and third-party suppliers that work on LBG premises delivering services to customers and supporting key business operations.

Diversity

The Board believes a diverse workforce is vital to the Group's success and values the differences each colleague brings to their role, making the Group stronger and better able to meet the needs of its customers. The Board supports colleague engagement through the Group's Race Action Plan introduced in July 2020 and female talent programmes in order to drive race-related cultural change, recruitment and progression to attract and retain diverse talent in the Group. The Group continues to have focus on increased Black representation, with a target in senior roles to at least 3 per cent by 2025. The Board's focus on inclusion and diversity has extended to all the jurisdictions in which the Group operates which have their own demographic profile. The Group has successfully launched a dedicated Inclusion and Diversity Forum to support the progress of initiatives including the Race Action Plan, gender and LGBTQ initiatives and diversity priorities such as disability awareness across all jurisdictions.

Communities

The directors acknowledge that the Group, as part of one of the largest financial service providers in the UK, has responsibilities to invest in the communities in which it operates, to help them prosper economically and build a more sustainable future. As such the directors receive regular updates on responsible and sustainable business activities.

The Group has aligned with LBG sustainability objectives, including the current 'Net Zero by 2050' climate pledge, which is a key part of the Group's ESG strategy and directly supports global external goals. Additionally, the Group continues to contribute towards LBG's Helping Britain Recover strategy.

The directors actively support the delivery of LBG's ambition to be a leading UK bank in the Green/Sustainable Bonds market through the Bank's Green bond activity. Throughout 2021, the Group acted as bookrunner on 26 ESG-linked transactions, and led on the first UK ESG Residential Mortgage Backed Securities (RMBS) /Asset Backed Securities (ABS) issuance in Europe. The sector which the Group saw the highest increase in deals (compared to 2020) was Social Housing.

The Group is also active in reducing its Carbon Footprint by aligning with LBG's 3P's campaign; Partnerships, Prioritisation and Pace. To achieve this, it has provided additional staff training, promoted alternative business travel transport methods for client interactions and the use of commuting methods with lower carbon emissions, such as utilising the Cycle to Work scheme, and introduced tools to monitor progress.

The Group has been actively engaged in fundraising and volunteering events across its jurisdictions. The directors receive regular updates on how the Group is progressing on supporting its communities. Within the Crown Dependencies, the Group works with LBG's charitable foundations, such as the Lloyds Bank Foundation for the Channel Islands which supports several charities through grants and a wide range of developmental support to help local communities thrive. In North America, the Group has completed fundraising for a local foodbank charity, City Harvest, to reduce food poverty. In Singapore, the Group has supported the building of a local school and in the UK, a number of colleagues volunteer as school governors, support local sports initiatives and have trained to support the COVID-19 relief effort.

Suppliers

The Board recognises the importance of partners who provide aspects of our operations and customer service provision through the shared service model (SSM) with LBG. The Bank's approach to external supplier management follows that of LBG, working with suppliers of varying sizes, most in professional services sectors such as IT, cyber, operations, management consultancy, legal, human resources, marketing, and communication. The supply chain is crucial to the way the Bank and LBG serves its customers, and through it the reach is considerable.

The Group and LBG seek to improve the experience of suppliers, with feedback regularly sought on related assurance processes to ensure continued improvement in the process. Suppliers are also encouraged to express their satisfaction or otherwise and have access to LBG and the Bank's whistleblowing service.

Importance is placed on having the right supplier framework to operate responsibly. LBG's Sourcing & Supply Chain Management Policy applies to all businesses, divisions, and subsidiaries of LBG, including the Bank, with the directors assuming ultimate responsibility for its application as relevant to the Bank. This Policy has been designed to assist in managing the inherent risk in outsourcing services, and in dealing with third-party suppliers. Suppliers are required to adhere to relevant LBG policies and comply with LBG's Code of Supplier Responsibility which can be found on the LBG website. This defines expectations for responsible business behaviour, underpinning the efforts of the Bank and LBG to share and extend good practice. All material contracts are subject to rigorous cost management governance with regular review of key supplier risks.

The operation of the Group's supply chain is through LBG. The Board supports LBG's zero tolerance attitude towards modern slavery in LBG's supply chain and an assurance process of the measures which address the risk of human trafficking and modern slavery in the wider supply chain is undertaken by the Group.

The Board recognises the increased need for oversight and governance to manage the risks highlighted by the regulators of increased levels of third-party services within the financial services industry and the reliance on third party/outsourced service providers to support or provide critical and regulated activities. The European Banking Authority ('EBA') Outsourcing Guidelines became effective in September 2019, for new outsource arrangements, with a transitional period through to the end of December 2021 to bring existing outsourcing arrangements into compliance. The PRA Supervisory Statement (SS) 2/21 on Outsourcing and Third Party Risk Management (TPRM), which aligns to EBA guidance, clarifies the existing requirements on outsourcing and third-party risk management and provides further guidance. The Board is aware of the work being undertaken by the Group and LBG to meet the requirements and the need for clear oversight of material outsourcing risks to the business and receives regular updates.

Regulators

The Bank and its directors maintain an open, and transparent relationship with relevant regulators and other authorities and liaise regularly both directly and as part of LBG to ensure business aligns to the requirements of these important stakeholders.

Regulatory Agenda

The Chair and individual directors have in the ordinary course of business had continuing discussions with the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) on a number of aspects of the regulatory agenda. The Board in turn reviewed regular updates on this and progress being made in addressing key regulatory priorities. Key areas of interest for the Board have included ensuring robust prudential standards, the fair treatment of customers, and the response to market changes. During the year such changes have included not only the ongoing response to COVID-19, but IBOR cessation, climate change responsibilities, and ensuring the Bank's ongoing financial and operational resilience including for the prevention of financial crime. Regular updates at Board Risk Committee also cover all aspects of the regulatory agenda including emerging regulatory and legal risks. This provides a focused view of areas of priority alongside detail of regulators' actions. The Board continues to closely monitor the status of the Bank's regulatory relationships across all the jurisdictions in which it has a presence, seeking to enhance engagement particularly in key areas of regulatory change. During the coming year, this is expected to continue to include the ongoing impacts of COVID-19, IBOR cessation, credit risk including the standardised approach to counterparty credit risk (SA-CCR), and climate risk management.

Principal risks and uncertainties

The most significant risks that could impact the Group's ability to deliver its long-term strategic objectives, and approach to managing each risk, are reviewed and reported to the Board Risk Committee regularly.

Overview

The COVID-19 pandemic had, and will likely continue to have, an adverse impact on the Group's business. The ultimate impact on our clients and financial results cannot be predicted. The scope and duration of the pandemic, and future actions of governments and authorities in response, remain highly uncertain.

2021 continued to be dominated by COVID-19 and new viral strains, such as Alpha, Delta and most recently Omicron, that continue to have an impact on the Group's principal risks directly or indirectly.

– After an uneven start to the year, economic conditions have steadily improved through 2021 in countries where the Group operates as vaccine programmes were successfully deployed in the UK and across developed economies. The on-going responses of policymakers will remain a key factor in public health, impacts on our clients and broader macro-economic conditions
– Government support schemes and policies have successfully supported macro-economic growth and lowered unemployment levels but have also caused a significant increase in public debt levels and excess liquidity. Many central banks are now considering a tightening in monetary policy in reaction to higher than forecasted levels of inflation
– Supply chain hindrances, rising energy and commodity prices and an overstretched labour market are placing upward pressure on inflation around the world, which has led to higher interest rates and debt burdens for the Group's clients and customers
– Credit risk concerns have eased over the course of the year as expected credit loss provisions declined and migrations to impaired status did not occur. Bankruptcy levels remain lower than expected. Nevertheless, the Group remains cautious as the unwinding of government support could impact clients with higher debt levels, particularly those that have received government assistance during the pandemic
– The Group's business proved resilient during the pandemic with trading activity increasing as financial markets became more volatile. As the situation stabilised, the Group was able to take advantage of improved funding conditions and business opportunities
– The pandemic continues to impact colleagues and has accelerated the transition to new ways of working and the adoption of a hybrid workplace model. Attrition and absentee rates continue to be a risk in key business areas, including the shared service, due to factors such as increased competition for talent and volatile infection rates
– Non-financial risk remains a concern as challenges are faced in the execution of complex regulatory projects, the continued reliance on non-automated controls and the need to evolve in line with the ever-changing cyber risks and threats.

Geopolitical uncertainty or instability could negatively impact the Group's operations and financial performance.

Geopolitical developments impacting the UK, the USA, Europe and other countries can cause uncertainty and instability in the economic environment and markets in which the Group operates its business. The outbreak of war between Russia and Ukraine in February 2022 is causing serious economic, political, social and humanitarian consequences in Europe and beyond. While the Group's exposure to Russia, Ukraine and surrounding countries is not material, prolonged conflict could have the following impacts:

– Adversely impact the credit worthiness of clients with which the Group does business
– Increase financial market volatility and dislocation in funding and financial markets
– Reduce economic activity, cause higher inflation and lead to recession
– Imposition of sanctions and retaliations, increasing economic crime risk
– Higher frequency and severity of cyber-attacks
– Change the path of monetary and fiscal policy
– Contraction in the demand for credit and widening credit spreads
– Sovereign debt default

These risks could have an adverse impact on the Group's financial performance through higher levels of provisions, decreased business activity and higher funding costs. The imposition of sanctions could lead to higher levels of economic crime risk and more severe cyber-attacks have the potential to impact operational resilience.

Changes in regulation or oversight could have a material adverse impact on the Group's operations

The Group is subject to extensive regulation, supervision and examination by regulatory bodies in countries where the Group has a presence, as well as from wider initiatives focusing on areas such as capital (e.g. CRD IV). This regulation and supervision define the activities in which the Group may engage, as well as the prudential and capital requirements that must be complied with, and authorities have significant discretion in their supervisory and enforcement activities. Any change in such regulation (previous examples of which include the phasing out of LIBOR, the introduction of data protection legislation and alterations to the required approach to market risk) could have a material adverse impact on the Group's business, financial condition or operating results as follows:

– Fines or censure for regulatory non-compliance that could impact the Group's reputation and results of operations
– Additional capital requirements for inadequate compliance with regulation that could restrict business activity
– The imposition of limitations on the extent or scope of business activities
– Increase compliance costs and impact our business model

The future relationship of the UK and EU remains uncertain and adverse developments could impact the Group's business operations

Following the UK's exit from the EU, there is continued uncertainty as to what the future UK legal and regulatory framework will look like, noting the potential for the UK to deviate from the EU's legal and regulatory system. Since the UK's departure from the EU, the Group offers a limited set of products to European clients, through its German subsidiary, Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH. The current focus is on bond origination, underwriting and distribution for EEA issuer clients and secondary trading and distribution to EEA investor clients. Changes to European regulations, following UK's exit from the EU, have restricted the scope and manner in which this entity is able to conduct business, given the need for further licensing to undertake certain activities.

Disruptions are being experienced across the UK, including trade challenges due to stringent EU regulations, labour shortages created by EU workers departure, disputes on Northern Ireland border rules and a renewed call for Scottish independence. These challenges may impact some of our clients' ability to operate and lead to higher levels of credit risk. If more companies move parts of their operations to Europe, there is a risk that they will switch to competitor banks with a more comprehensive EU offering. Regulatory changes, including final CRD IV legislation, could impact cross-border activity from the UK into the EU. Both of these risks could have an adverse impact on business operations and our ability to achieve revenue targets.

The transition from LIBOR to Risk Free Rates could have an adverse impact on the Group's operations and financial performance

The UK's FCA, which regulates LIBOR, stopped compelling banks to submit LIBOR rates after 2021. The Group has substantial exposure to loans, securities and derivatives that reference LIBOR and must be transitioned to risk-free rates.

- During 2021, the Group progressed its transition to alternative benchmark rates under the LBG-wide IBOR transition programme and has delivered the core changes required to its technology and business processes. Through this programme, the Group has ensured that the most appropriate benchmark rate is used for new products, has transitioned the vast majority of its legacy products to new benchmark rates and has managed the impacts and risks relating to systems, processes, accounting and reporting. The Group does not expect material changes to its risk management approach and strategy as a result of interest rate benchmark reform
- At 31 December 2021, the Group had successfully transitioned derivative products settled though the London Clearing House (LCH) that were dependent on Sterling, Euro, Japanese Yen and Swiss Franc LIBOR to alternative benchmark rates and has transitioned the majority of its commercial lending contracts from Sterling LIBOR to alternative benchmark rates. US Dollar LIBOR is not expected to cease before 30 June 2023 and the Group continues to work on its planned transition to alternative benchmark rates for those financial contracts currently referencing US Dollar LIBOR. Further details are provided in note 34.

The transition away from LIBOR to alternative reference rates is complex and could adversely impact our business, financial condition, and results of operations. In particular, the transition could have the following impacts on the Group and our clients

- Adversely impact the interest rates on loans, deposits, derivative and other financial obligations tied to LIBOR rates
- Adversely affect the value of loans, deposits, derivatives and other financial obligations tied to LIBOR rates
- Result in disputes, litigation or other actions with counterparties and clients regarding the interpretation and enforceability of fallback language in LIBOR-based products or the way in which the client interaction and transition has been conducted
- Increase exposure to less liquid interest rates, where a fallback rate has not been agreed, such as Synthetic LIBOR
- Lead to higher operational risk as new reference rates are implemented across the Group's system landscape

Management's ability to retain key colleagues could change over time and could impact the Group's operations and financial performance

The Group's operating performance is dependent on the continued service of its executive officers and colleagues. Our operating results are also dependent in significant part upon the ability to attract and retain qualified colleagues. The competition for qualified staff has intensified and the Group cannot ensure success in attracting or retaining key personnel. The Group's business, financial condition and results of operations could be materially adversely impacted by the loss of key employees or its inability to attract and retain skilled personnel.

We could suffer operational, reputational and financial harm if our models are not implemented correctly or are used inappropriately

The Group uses proprietary models to forecast losses, measure capital requirements, make business decisions and assess and control our operations and financial condition. Model Risk Management is an independent risk function that defines model risk governance and policy based on laws, rules and regulations. Models are inherently subject to limitations due to their use of historical data and trends, simplifying assumptions and reliance on uncertain macroeconomic and financial variables. Our models may not be sufficiently predictive of future results due to limited historical data, extreme market volatility, parameterisation and implementation errors. In addition, our models may be ineffective if we fail to oversee them and detect flaws in the review and monitoring process. Irrespective of the steps we take to ensure effective controls, governance, monitoring and testing, we could suffer operational, reputational or financial harm if models do not properly anticipate and manage current and future risks.

The Group continues to work to protect customers, colleagues and society from harm by mitigating economic crime risks, which could result in higher operational and compliance costs and adversely impact operations in the event of non-compliance

The Group is exposed to fraud and other economic crime risks such as money laundering, bribery and sanctions evasion. The Group continues to invest in systems and controls in order to detect and prevent illicit activity. COVID-19 has resulted in increased economic crime prevention challenges, including exacerbated challenges relating to the maintenance of 'know your customer' information. Failure to appropriately maintain customer information in accordance with the Money Laundering Regulations results in less effective anti-money laundering controls which consequently could lead to the facilitation of criminal activity, regulatory censure, fines, and/or loss of license. In addition, new forms of fraudulent activity have emerged as increasingly sophisticated criminals take advantage of the pandemic and those most vulnerable. For the Group, fraud losses are relatively low and largely driven by the Crown Dependencies retail business as personal customers are typically more likely to be the victims of fraud.

The Group is subject to the emerging risks associated with climate change

Climate risk is defined as the risk that the Group experiences losses and /or reputational damage as a result of climate change, either directly or through its customers. Climate risk can arise from physical risks such as changes in climate or weather patterns which are acute, event-driven (e.g. flood), or chronic, longer term shifts (e.g. rising sea levels or droughts). For example, extreme weather leads to damage to property and/or disruption to services, for the Group or its customers. Climate risk can also derive from transition risks such as changes associated with the move towards a low carbon economy, including changes to policy, legislation & regulation, technology and market, or legal risks from failing to manage these changes. For example, increased costs, exposure to climate-related litigation and reputational risk for the Group or its customers due to policy /legal changes in support of meeting global carbon emissions targets.

The Group is aligned with Lloyds Banking Group, its service provider, which has taken a strategic approach to align with the UK Government's clean growth strategy and has committed to adopting the approach set out by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) by 2022. Lloyds Banking Group has undertaken an analysis of the main potential physical and transition risks affecting its activities, as well as how these may impact across the different principal risks within Lloyds Banking Group's risk taxonomy. Further information on Lloyds Banking Group's approach to managing climate risk can be found in the 2021 Lloyds Banking Group Climate Report.

Understanding of climate risk is still evolving for both the Group and the wider industry. At this stage, climate risk cannot be considered in the same way as the Group's other principal risks given methodologies are still developing and assessment based on those currently available have a limited impact on the Group's business model. In terms of Lloyds Banking Group bank financed emissions, the Group contributed to less than 2%, as current Partnership for Carbon Accounting Financials (PCAF) standards and methodologies do not yet extend to cover material areas for the Group, such as derivatives. This has also been the case for the Bank of England's Climate Biennial Exploratory Scenario (CBES), which has excluded investment banking activities.

Internal and third party service provision failures could have an adverse impact on the Group's operations and result in higher costs

The provision of services to the Group supporting the business, operations and support functions is outsourced to Lloyds Bank plc via a shared service provision model or by external providers via Lloyds Bank plc. The shared service model leverages LBG capabilities to meet the needs of its customers and to manage its external suppliers effectively. References below to the Group's shared service provider refers to this arrangement.

In relation to the shared services model, the Group has worked on implementing the EBA outsourcing guidelines and the PRA's supervisory statement on Outsourcing and Third-Party Risk Management requiring Financial Institutions to enhance oversight of their internal and external suppliers by 31 December 2021 and 31 March 2022 respectively. This includes maintaining an outsourcing register, receiving operational data and assessing operational resilience. Given that a wide range of services are provided intra-group by Lloyds Bank plc or by external providers via Lloyds Bank plc, the process of producing legal entity specific metrics and data to facilitate efficient and proportionate oversight is a challenging and complex one.

The Group is highly dependent on its shared service provider and therefore issues impacting the shared service provider's ability to attract and retain staff with the right skills could have a detrimental impact on the Group's operations.

Principal risks

Credit risk
The risk that parties with whom the Group has contracted fail to meet their financial obligations (both on and off-balance sheet). Observed or anticipated changes in the economic environment could impact profitability due to an increase in delinquency, defaults, write-downs and/or expected credit losses.

Key mitigating actions

- Credit policy, incorporating prudent lending criteria, aligned with the Board-approved risk appetite, to manage risk effectively
- Robust risk assessment and credit sanctioning to ensure we lend appropriately and responsibly
- Extensive and thorough credit processes and controls to ensure effective and timely risk identification, management and oversight
- Effective governance processes delivered by the shared service and supported by independent credit risk assurances
- Early identification of signs of stress leading to engagement with the customer

Regulatory and legal risk
The risk arising from the failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements, leading to customer detriment, failure to prevent and/or detect economic crime, financial penalties, regulatory censure, criminal or civil enforcement action.

Key mitigating actions

- The Board has established a risk appetite metric for regulatory and legal risk
- Effective, well established compliance and legal risk management policies and procedures which ensure appropriate controls and systems are in place to comply with applicable laws, rules and regulations
- Robust framework and processes are in place to monitor on-going compliance with new legislation
- Continued investment in people, processes, training and IT to assess impact and help meet its legal and regulatory commitments
- On-going horizon scanning to identify and address changes in regulatory and legal requirements
- Effective engagement with regulatory authorities and industry bodies on forthcoming regulatory changes, market reviews and investigations
- Effective mechanisms for the business in place to identify, assess and monitor risks, providing appropriate management information, and with robust oversight and escalation routes

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

Key mitigating actions

- Simplified and enhanced conduct policies and procedures are in place to ensure appropriate controls and systems that deliver fair customer outcomes and support market integrity and competition requirements
- Conduct risk appetite metrics provide a granular view of how the Group's products and services are performing for customers through the customer life cycle
- Product approval, continuous product review processes and customer outcome testing (across products and services) supported by conduct management information
- Root cause analysis, enhanced complaint management and clear customer accountabilities for colleagues, with rewards driven by customer-centric metrics
- Further enhancements and embedding of its framework to support all customers, including in particular those in vulnerable circumstances
- Achieve a values-led culture through a focus on behaviours to ensure it is transforming its culture for success in a digital world. This is supported by strong direction and tone from senior executives and the Board
- Review and oversight of thematic conduct agenda items at senior committees, ensuring holistic consideration of key conduct risks

- Robust recruitment and training, with a continued focus on how the Group manages colleagues' performance with clear customer accountabilities
- On-going engagement with third-parties involved in serving the Group's customers to ensure consistent delivery

Operational risk
The risk of inadequate or failed internal processes, people, systems or from external events leading to loss. This includes cyber-attack, internal and/or external fraud or financial crime, IT systems failures or, failure to ensure compliance with associated increasingly complex and detailed regulation.

Key mitigating actions

- The risk management framework establishes robust arrangements for risk governance, in particular through clear definition of individual and collective accountabilities for risk management, risk oversight and risk assurance through a three lines of defence model which supports the discharge of responsibilities to customers, shareholders and regulators
- Continued investment in the control environment by both the group and its shared service provider, with a move towards automated preventative and real-time detective controls
- Manual and detective controls deployed on an interim basis to prevent gaps as more strategic controls are developed and deployed
- Deployment of enhanced cyber controls to detect, protect against and respond to threats to the confidentiality or integrity of information assets, or the availability of systems, and to ensure effective assurance of third-party provision
- Enhancing technology infrastructure and the resilience of systems (including focus on simplification of IT architecture and the decommissioning of legacy systems) that support critical business processes
- Application of a risk-based approach to mitigate financial crime and both internal and external fraud risk
- Working with industry bodies and law enforcement agencies to identify and combat fraud and money laundering
- Rigorous oversight of relevant management at business area and entity-level committees
- Explicit focus on the effectiveness of these mitigants in the context of changes arising from/in response to COVID-19

Operational risk: shared services model (SSM)
Lloyds Banking Group's chosen ring-fencing operating model introduces risk for the Group in the execution of that model as a shared service recipient.

Key Risks include:

- Key reliance on the SSM increases the prominence of internal service provision risk which is compounded, given the leanness of the relevant teams, in situations where the Group's priorities are not wholly aligned with those of the wider Lloyds Banking Group
- Business process risk (i.e. non-adherence to key processes, including those relating to market, operational, capital, credit, economic crime prevention and funding & liquidity risk)
- Information security & cyber risk including access management, records, data protection and cyber
- IT systems risk due to reliance on the shared service from Lloyds Banking Group's IT department
- Reliance on the SSM to operate a number of key controls and processes designed to detect, prevent and respond to economic crime
- Operational risk around business resilience, change activity and sourcing
- Impact of resourcing challenges LBG might face around attracting and retaining people with the necessary skills

Key mitigating actions

The Group has arrangements in place to assess, monitor and take action on risks arising from the Shared Services Model which include:

- Service performance & reporting to ensure that management information is provided to the Group executive to monitor and respond to the effectiveness of the service provision
- An established process put in place to highlight and work through conflicts of interest between the Group and the wider Lloyds Banking Group where they arise and could impact delivery of the SSM
- Service agreements in the form of a legally binding Intra-Group Agreement (IGA) is in place to ensure required standard for services
- Service governance arrangements to ensure that the Group can manage, monitor and escalate service risks to relevant Boards
- Service audit rights are incorporated within the IGA, allowing the Group to audit the services provided by Lloyds Banking Group

Operational resilience risk
The risk that the Group fails to design resilience into business operations, underlying infrastructure and controls (people, process and technical) to withstand external or internal events that could impact the continuity of operations or alternatively the failure to respond to events in a way which meets stakeholder expectations and needs when the continuity of operations is compromised.

Key mitigating actions

- Designing resilience into the Group's operations to enable it to be able to withstand and recover from unexpected events
- Identification of the Group's critical business processes and investing in technology to enhance the resilience of systems supporting them, primarily through Lloyds Banking Group technology resilience programme
- Continued investment, through Lloyds Banking Group, to improve identification and access management, improving capability to detect and respond to cyber-attacks and improved ability to manage vulnerabilities across the estate.
- Setting recovery targets for those processes in line with regulatory guidance
- Ensuring it has resilience capability for those services
- Testing that capability regularly
- Ensuring that the operational resilience risk profile needs are reassessed and prioritised in line with strategic change
- Setting, monitoring and operating within the Board level risk appetite
- Continued optimisation and investment in people controls and processes, property and sourcing programme

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

Key mitigating actions

The Group has sought to implement mitigating actions with respect to People risk; these continue to be significant areas of focus in light of the on-going challenges brought by the pandemic. Key objectives of this effort have included:

- Focusing on leadership and colleague engagement, with an emphasis on general and targeted strategies to attract, retain and develop high calibre people together with implementation of rigorous succession planning
- Continued focus on the Group's culture and Inclusion & Diversity strategy by developing and delivering initiatives that reinforce the appropriate behaviours which generate the best possible long-term outcomes for customers and colleagues
- Managing organisational capability and capacity to ensure that the Group have the right skills and resources to meet its customers' needs and deliver its strategic plan
- Evolving remuneration arrangements effectively to ensure they promote an appropriate culture and colleague behaviours that meet customer needs and regulatory expectations
- Ensuring colleague wellbeing strategies and support are in place to meet colleague needs and encourage a growth mindset
- Ensuring compliance with the Senior Manager & Certification Regime, embedding compliant and appropriate colleague behaviours in line with Group policies, values and its people risk priorities
- Reviewing and enhancing people processes to ensure they are fit for purpose and operationally resilient
- Key people resources provided under the shared service model are managed under an adequate people services agreement

Capital risk
The risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group.

Key mitigating actions

- A comprehensive capital management framework that includes setting of capital risk appetite and dividend policy
- Close monitoring of capital and leverage ratios to ensure they meet regulatory requirements, remain within Board risk appetite and deploy capital resources efficiently
- Comprehensive stress testing analyses in place to evidence capital adequacy
- Maintaining a recovery plan setting out a range of potential mitigating actions that could be taken in response to a stress

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

Key mitigating actions

- Ensuring that the Group's liquidity risk management framework is adequate with regard to the internal risk appetite, strategy and regulatory requirements. Liquidity policies and procedures are subject to independent internal oversight by the Risk team.
- Holding a liquidity buffer to cover potential cash and collateral net outflows calibrated to support strategic and operational needs as well as regulatory requirements
- Undertaking daily monitoring against a number of market and entity specific early warning indicators complemented with stress testing analysis
- Maintaining a contingency funding plan detailing actions and strategies available in stressed conditions
- Diversified funding sources including a Euro Medium Term Notes programme

Market risk
The risk that the Group's capital or earnings profile is affected by adverse market rates, in particular changes and volatility in interest and foreign exchange rates, inflation rates, commodity prices and credit spreads through activity in the banking and markets businesses.

Key mitigating actions

- Setting an appropriate market risk policy in line with risk appetite, operating within its parameters and the supplementary procedures that underpin it,
- Undertaking regular monitoring of market risk positions versus limits and triggers to ensure they remain within limits which are calibrated in line with risk appetite
- Mitigating actions vary depending on exposure but, in general, seek to reduce risk in a cost-effective manner including the externalisation to financial markets where market liquidity allows
- Structural hedge programmes implemented to manage liability margins and margin compression

Model risk
The risk of financial loss, regulatory censure, reputational damage or customer detriment from deficiencies in developing, applying and operating models and rating systems.

Key mitigating actions

- A comprehensive model risk management framework established by and with continued oversight from the second line of defence, provides the foundation for managing and mitigating model risk within the Group including:
- Defined roles and responsibilities, with clear ownership and accountability
- Principles regarding the requirements of data integrity, development, validation, implementation and on-going maintenance
- Regular model monitoring

- Independent review of models
- Periodic validation and re-approval of models

Data risk
The risk of the Group failing to effectively govern, manage, and control its data (including data processed by third party suppliers) leading to unethical decisions, poor customer outcomes, loss of value to the Group and mistrust.

Key mitigating actions

- Introducing advanced data management practices to deliver compliance with Basel Committee on Banking Supervision (BCBS) 239, based on standards consistently applied by the Group and (where appropriate) Lloyds Banking Group as service provider, a data-first culture, supported by enhancements to enterprise data platforms and the simplification of the IT architecture
- Ensuring that risks are identified, measured, managed, monitored and reported using the risk and control self-assessment process
- Employing the infrastructure delivered via the General Data Protection programme
- Developing capability by investing in professional training for data privacy managers
- Enhancing assurance over third party suppliers
- Improving controls and processes for data retention and destruction

Governance risk

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

Key mitigating actions

The LBCM Risk Management Framework (RMF) establishes robust arrangements for risk governance, in particular by:

- Defining individual and collective accountabilities for risk management, risk oversight and risk assurance through a three lines of defence model which supports the discharge of responsibilities to customers, shareholders and regulators
- On-going monitoring of governance arrangements and key activities to ensure appropriateness, and compliance against regulatory requirements this includes, but is not limited to, the Corporate Governance Framework (the Board and its Committees and the Executive Committees), Shared Service and Credit Governance
- Regular monitoring of the Governance Risk profile and performance, and reporting through the consolidated Risk Report to LBCM Risk Committee, Board Risk Committee and the Board
- Effective implementation of the RMF mutually reinforces and is reinforced by the Group's and LBCM's risk culture, which is embedded in its approach to recruitment, selection, training, performance management and reward

Change / execution risk
The risk that, in delivering its change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within the Group's risk appetite.

Key mitigating actions

- Setting (and operating within) the Board level risk appetite for change and execution risk. The Group monitors metrics provided by LBG as service provider at sub-board level.
- Ensuring compliance with the change policy and associated policies and procedures, which set out the principles and key controls that apply across the business and are aligned to risk appetite
- Assessment by the business of the potential impacts of undertaking any change activity on its ability to execute effectively, and the potential consequences for the existing risk profiles
- Implementation of effective governance and control frameworks to ensure the adequacy of controls to manage the change activity and act to mitigate the change/execution risks identified
- Escalation of events related to change activities to ensure that they are managed appropriately in line with risk framework guidance

Strategic risk
Strategic risk is defined as the risk which results from:

- Incorrect assumptions about internal or external operating environments
- Failure to understand the potential impact of strategic responses and business plans on existing risk types
- Failure to respond or the inappropriate strategic response to material changes in the external or internal operating environments

Key mitigating actions

- Horizon scanning is conducted across the Group to identify potential threats, risks, emerging issues and opportunities and to explore future trends
- The Group's business planning processes include formal assessment of the strategic risk implications of new business, product entries and other strategic initiatives
- The Group's governance framework mandates individuals' and committees' responsibilities and decision-making rights, to ensure that strategic risks are appropriately reported and escalated

Financial risk management objectives and policies
Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in notes 32 and 34 to the accounts. The Group's approach to risk management including risk policies, risk appetite, measurement bases and sensitivities, in particular for credit risk, market risk and liquidity risk, is aligned to those of Lloyds Banking Group plc, the Bank's ultimate parent. Further information can be found in the Lloyds Banking Group plc annual report.

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

– Ensure that accounting policies are appropriately and consistently applied
– Enable the calculation, preparation and reporting of financial outcomes in line with applicable standards
– Ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements

The 2021 Strategic report has been approved by the Board.

On behalf of the Board

Eduardo J Stock da Cunha
Director
Lloyds Bank Corporate Markets plc
24 March 2022

The directors present their annual report and audited consolidated financial statements for the year ended 31 December 2021.

Information included in the Strategic report incorporated by reference	Pages
Statement of employee engagement	4
Statement of other stakeholder engagement	4 to 6
Principal risks and uncertainties	7 to 12

Results
The consolidated income statement on page 30 shows a statutory profit before tax for the year ended 31 December 2021 of £289 million (year ended 31 December 2020: £45 million).

Dividends
During the year the Bank paid an interim dividend of £200 million, which was paid in April 2021 (2020: £700 million). The directors have not recommended a final dividend for the year ended 31 December 2021. In March 2022, the directors approved the payment of an interim dividend of £220 million which will be paid by the end of April 2022.

Post balance sheet events
In February 2022, the Board made the decision to close the Singapore branch of the Bank during 2022.

Going concern
The going concern of the Bank 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 Bank and the Group have adequate resources to continue to operate for the foreseeable future, the directors have reviewed the Group's operating plan and its funding and capital positions, including a considerations of the short term implications of the COVID-19 pandemic. The directors have also taken into account the impact of further stress scenarios as well as a number of other key dependencies which are set out in the principal risks and uncertainties and capital sections of the Strategic report on pages 1 to 13.

Accordingly, the directors conclude that the Bank and the Group have adequate resources to continue in operational existence for a period of at least 12 months from the date of the approval of the financial statements and therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts

Corporate Governance Statement

Approach to corporate governance
In accordance with the "Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018)" (the Regulations), for the year ended 31 December 2021, the Bank and Group has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the Principles) which are available at frc.org.uk. The following section explains the Bank's approach to corporate governance, and its application of the Principles.

Fundamental to the Bank and Group's strategy are high standards of corporate governance. A Corporate Governance Framework is in place for the Bank, which sets the approach and applicable standards in respect of the Bank's corporate governance arrangements whilst addressing the matters set out in the Principles.

This includes the matters reserved to the Board, and the matters the Board has chosen to delegate to management, including decision making on operational matters such as those relating to credit, liquidity and the day-to-day management of risk, and the governance requirements of the operation of the Bank as an entity outside of LBG's Ring Fenced Bank. Governance arrangements, including the Corporate Governance Framework, are reviewed at least annually to ensure they remain fit for purpose. The Corporate Governance Framework of the Bank further addresses the requirements of the Principles as follows.

Principle One – Purpose and Leadership
The Board is collectively responsible for the long-term success of the Bank. It achieves this by agreeing the Bank's strategy, within the wider strategy of LBG, and overseeing delivery against it. The Bank's strategy is discussed further in the Strategic report on pages 1 to 13. The Board also assumes responsibilities for setting the culture, values and wider standards of the Bank, within the equivalent standards set by LBG.

During the year, the COVID-19 pandemic continued to have a profound effect on the way we live and as the pandemic restrictions began to be lifted the Board responded to the new ways of working ensuring virtual options were available at Board and Committee meetings to minimise risks for both Board members, attendees and colleagues. The Board continued to receive frequent COVID-19 updates from management (both formally and informally) covering matters such as the impact on customers, colleagues, suppliers and other stakeholders and on funding and liquidity.

Consideration of the needs of all stakeholders is fundamental to the way the Bank operates, as is maintaining the highest standards of business conduct, which along with ensuring delivery for customers is a vital part of the corporate culture. The Bank's approach is further influenced by the need to build a culture in which everyone feels included, empowered and inspired to do the right thing for customers. To this end, the Board plays a lead role in establishing, promoting and monitoring the Bank's corporate culture and values, with the Corporate Governance Framework ensuring such matters receive the level of prominence in Board and Executive decision making which they require. The Board receives regular updates on the Group's culture including progress on the cultural transformation journey, which is closely aligned to those of LBG, which are discussed in more detail on page 80 of the LBG Annual Report and Accounts for 2021.

Principle Two – Board Composition
The Board is chaired by a Non-Executive member of the LBG Board and contains a balance of independent Non-Executive Directors, LBG executives (serving as Non-Executives) and Executive Directors. This composition supports its legal and regulatory requirements for independent decision making within the overall framework of LBG policies and controls. Further details of the directors can be found on page 19.

There were a number of changes to the Board during the year, all of which were overseen by the Nomination and Governance Committee. Since the year end, John J Cummins left the Board as Chair of the Board Risk Committee and we have announced the appointment of Rupert Mingay as his successor subject to regulatory approval. As disclosed in last year's Annual report, Christopher J K Edis left the Board as Chief Financial Officer to take up another position within LBG and was succeeded by Julienne C Daglish on 22 April 2021, who was well known to the Board as the Bank's Chief Risk Officer, Letitia M Smith resigned as Non-Executive Director on 4 June 2021 following her announcement that she was retiring from LBG and was succeeded by Emma Lawrence on 7 June 2021 who is employed by LBG as Customer Management Director of the Retail Bank.

The Nomination and Governance Committee continues to keep under review, on an ongoing basis, the structure, size and composition of the Board and its committees, making recommendations to the Board as appropriate. Consideration is given to the need to ensure the appropriate mix of knowledge, skills and experience, and diversity.

The Board has adopted the LBG Board Diversity Policy and LBG Board Diversity Objectives as applicable to the Bank and reflecting the relative size of the Board. The Board has continued its commitment to maintaining at least two female board members so long as the board size is eight directors. Following the appointment of Eve A Henrikson in 2020, the board size increased to nine directors and with the appointment of Julienne C Daglish (to succeed Christopher J K Edis) and Emma L Lawrence (to succeed Letitia M Smith) the number of female directors has increased to four. Further, the Board supports the overall aspirations of the new FTSE Women Leaders Review, which has replaced the Hampton Alexander review and Parker Review goals reflecting that the Bank is a subsidiary and not a listed entity. The Board has made progress on its diversity policy aspirations with Black, Asian or Minority Ethnic representation of 11% at the year end. The Board will continue to take opportunities to increase ethnic diversity and the number of female board members over time where this is consistent with other skills and diversity requirements and is proportionate to the size of the Board and the Bank.

Reflecting the size and complexity of the business, the Board has established a committee structure comprising a Board Risk Committee, Audit Committee, Remuneration Committee and Nomination and Governance Committee (Committees). The Committees make recommendations to the Board on matters delegated to them, in particular in relation to internal control, risk, financial reporting and remuneration matters. Each Committee has written terms of reference setting out its delegated responsibilities and comprises independent Non-Executive Directors with appropriate skills and experiences and chaired by an experienced Chair. The Committee Chairs report to the Board at each Board meeting.

The Board undertakes an annual review of its effectiveness, which provides an opportunity to consider ways of identifying greater efficiencies, ways to maximise strengths and highlights areas of further development. During the year under review, Nomination and Governance Committee provided oversight of an internal review, conducted by the Company Secretary, of the effectiveness of the Board, its committees and the individual directors having commissioned an external review during 2020. The internal review process included a confidential open-ended questionnaire to the Board and Committees, a confidential Chair and peer review and a short pulse survey seeking views of the senior executive population providing an holistic review of performance. The internal evaluation included an appraisal of each director and Lord Lupton, as Chair. The Senior Independent Director led the appraisal of the Bank's Chair.

The internal evaluation concluded that the Board oversees the management of the Group effectively and has the appropriate skills and expertise to protect the interests of all stakeholders. Its directors benefit from diverse but complementary skills and experience in financial markets and institutions, technology and consumer-facing businesses in the UK and overseas, and all make valuable contributions to the Board. While the evaluation did not highlight any material weaknesses or concerns, it identified some areas of focus in the future, including: (1) finding more time on the Board agenda for open discussion of strategy/ forward-looking issues; (2) LBCM and LBG collaboration and relationships; (3) enhancing Board reporting and papers; and (4) technical training for directors in such areas as crypto currency and sustainability. The Board was pleased with the progress against the actions from the 2020 review.

The internal Board evaluation also considered the activities of the Audit, the Board Risk, the Nomination and Governance, and Remuneration Committees. It concluded that the Committees were operating effectively, with the right balance of membership, experience and skills.

Principle Three – Director Responsibilities
The Board has established and maintains corporate governance practices that provide clear lines of accountability and responsibility to support effective decision-making through the Corporate Governance Framework. This also helps clarify the relationship between the Bank and its parent company in order to deliver long-term sustainable success. Policies are also in place in relation to potential conflicts of interest which may arise. All Directors have access to the services of the Company Secretary, and independent professional advice is available to the Directors at the expense of LBG, where they judge it necessary to discharge their duties as directors.

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

Principle Four – Opportunity and Risk
The Board oversees the development and implementation of the Bank's strategy, within the context of the wider strategy of LBG. Consideration is given to strategic opportunities, and the Board's annual cycle of meetings includes sessions dedicated to debating strategic priorities and 'Extended business updates' into business areas and key risk areas, as well as one meeting focused on strategy.

The Board is also responsible for the long-term sustainable success of the Bank, ensuring it generates value for its shareholder and delivers a positive contribution to society. The Board agrees the Bank's culture, purpose, values and strategy within those set by LBG, and sets expectations for risk management, financial performance and reporting. The specific aims and objectives of the Board are formalised within the Bank's Corporate Governance Framework, which also sets out the key decisions and matters reserved for the Board's approval.

Strong risk management is central to the Bank's strategy along with a robust risk control framework which acts as the foundation for sustainable business growth. The Board agrees the Bank's risk appetite, within the overarching risk appetite of LBG, and monitors the effectiveness of risk management with the support of the Board Risk Committee. Board level engagement, coupled with the direct involvement of senior management ensures that escalated risk issues are promptly addressed, and remediation plans are initiated where required.

The Bank's risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of LBG, and are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Bank's principal risks are discussed further on pages 9 to 12.

Principle Five – Remuneration
The Remuneration Committee of the Board is responsible for reviewing and making recommendations to the Board on the remuneration policy for the Bank. This includes reviewing performance and approving remuneration arrangements ranging from the remuneration of directors and members of the Executive to that of all other colleagues where the regulators require the Bank to implement a specific approach to their remuneration, such as Senior Managers and other material risk takers. The activities of the Remuneration Committee extend to matters of remuneration relevant to subsidiaries of the Group, taking into account the principles, policies and governance requirements of LBG and the recommendations of LBG's Group Remuneration Committee.

Principle Six – Stakeholders
The Bank, as part of LBG, operates under LBG's wider Responsible Business approach, which acknowledges that the Bank has a responsibility to help address the economic, social and environmental challenges which the UK faces, and as part of this understand the needs of the Bank's external stakeholders, including in the development and implementation of strategy. Central to this is LBG's Helping Britain Recover commitments, as part of the Helping Britain Prosper plan, in which the Bank participates, to help the UK, and stakeholders across the jurisdictions in which the Group operates, recover from the impact of COVID-19 as overseen by LBG's Responsible Business Committee.

In 2021 LBG's Responsible Business Committee provided further oversight and support of LBG's and the Bank's plans for embedding responsible business in the Bank's core purpose and ensuring that the Helping Britain Recover commitments were fully embedded into business plans and that they remain flexible to respond to the changing needs. The workforce, as a key stakeholder, includes the Bank's permanent employees, contingent workers and third-party suppliers delivering services to customers and supporting key business operations. This also includes LBG colleagues providing services to the Bank under the Shared Service Model. The Board's approach to workforce engagement includes an annual programme of engagement activity and oversight of policies on remuneration structures and practices that take account of the broader operating context, including the pay and conditions of the wider workforce and the Bank's response to matters such as any gender pay gap.

Appointment and retirement of directors
The appointment of directors is governed by the Bank's articles of association and the Companies Act 2006. The Bank's articles of association may only be amended by a special resolution of the shareholders in a general meeting.

Directors
The names of the current Directors are shown on page 19. Changes to the composition of the Board since 1 January 2021 up to the date of this report are shown in the table below.

	Joined the Board	Left the Board
Christopher J K Edis		5 April 2021
Julienne C Daglish	22 April 2021	
Letitia M Smith		4 June 2021
Emma L Lawrence	7 June 2021	
John J Cummins		28 February 2022

Directors' indemnities and Directors' and Officers' liability insurance
The directors of the Bank, including the former directors, have entered into individual deeds of indemnity with LBG which constitutes 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the directors who joined the Board during 2021. Directors no longer in office but who served on the Board at any time in the financial year and since year end had the benefit of this deed of indemnity during that period of service. The indemnity remains in force for the duration of a director's period of office. The deeds indemnify the directors to the maximum extent permitted by law. In addition, LBG has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

LBG has also granted deeds of indemnity by deed poll and by way of entering into individual deeds, which constitute 'qualifying third party indemnity provisions' to the Directors of the Group's subsidiary companies, including former Directors who retired during the year, and to colleagues subject to the provisions of the Senior Managers and Certification Regime. Such deeds were in force during the financial year ended 31 December 2021 and remain in force as at the date of this report. Qualifying pension scheme indemnities were granted to the Trustees of the Lloyds Banking Group's Pension Scheme relevant to the Bank, which were in force from 1 August 2021 and remain in force as at the date of this report.

Change of control
The Bank is not party to any significant agreements which take effect, alter or terminate upon a change of control of the Bank following a takeover bid. There are no agreements between the Bank and its directors or employees providing compensation for loss of office or employment that occurs because of a takeover bid.

Directors' interests
The directors do not have any direct interest in the shares of the Bank. Lord Lupton is also a director of LBG. Lord Lupton's interest in shares of LBG is shown in the report and accounts of that company.

Conflicts of interest
The Board has a comprehensive procedure for reviewing and, as permitted by the Companies Act 2006 and the Bank's articles of association, approving actual and potential conflicts of interest. Directors have a continuing duty to notify the Chair and the Company Secretary as soon as they become aware of actual or potential conflict situations. Changes to the commitments of all directors are reported to 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.

Lord Lupton is a senior adviser to Greenhill Europe, an investment bank focused on providing financial advice on significant mergers, acquisitions, restructurings, financings and capital raising to corporations, partnerships, institutions and governments. The Board has recognised that potential conflicts may arise as a result of this position. The Board has authorised the potential conflicts and requires Lord Lupton to recuse himself from discussions, should the need arise.

Andrew J McIntyre is Non-Executive Director, Senior Independent Director and Chair of the Audit and Risk Committee of C. Hoare & Co., a UK regulated private bank. During the year he was appointed as Non-Executive Director and Chair of Audit Committees of Target Group Limited and its subsidiaries, a wholly owned subsidiary group of Tech Mahindra Limited based in India which provides transformational outsourcing, business process management and managed services to the financial services sector. The Board has recognised that potential conflicts may arise in relation to these positions. The Board has authorised the potential conflicts and requires Andrew J McIntyre to recuse himself from discussions, should the need arise.

John J Cummins is CEO, Aviva Capital Partners; Non-Executive Director and member of Risk, Capital & the Credit Committee of ABSA Group Limited, a South African bank; and a director and trustee of Centre for Cities, a charitable company limited by guarantee set up as a think tank to improve the performance of UK city economies and conduct research into urban matters. In addition, John J Cummins has personal investments in a Fintech company, Shieldpay, a developer and supplier of secure anti-fraud payment systems to banks and other organisations;

and Auden Group Limited, a social lending company. John J Cummins left the Board on 28 February 2022. The Board recognised that potential conflicts may have arisen as a result of these positions. The Board authorised the potential conflicts and required John J Cummins to recuse himself, as appropriate, until he left the Board on 28 February 2022.

The following Non-Executive Directors hold/held executive roles within LBG and whilst these are permitted interests under the Bank's articles of association, for the sake of good order the Board authorised the potential conflicts that may arise as a result of those roles and required the individuals listed below to recuse themselves from discussions, should the need arise. These individuals did not act as representative of the Group's sole shareholder, LBG, in their capacity as Non-Executive Directors of the Bank's Board:

Name	LBG role
Emma L Lawrence	Customer Management Director, Retail Bank
Carla Antunes-da-Silva	Group Strategy, Corporate Development and Investor Relations Director for LBG and attendee of GEC
Letitia M Smith	Group Director, Conduct, Compliance & Operational Risk and attendee of GEC until June 2021

Branches, future developments and financial risk management objectives and policies
The Bank and the Group provides a wide range of banking and financial services through branches and offices in the UK, the USA, Germany and the Crown Dependencies. Following a strategic review, it has been decided to close the Singapore branch during 2022. 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 25. This information is incorporated into this report by reference.

The Bank did not issue share capital and did not repurchase any of its own shares during the year. There are no restrictions on the transfer of shares in the Bank 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 Bank under the powers set out in the Companies Act 2006 and the Bank's articles of association; these powers include those in relation to the issue or buy back of the Bank's shares. The Bank is a public company limited by shares.

Information required under DTR 7.2
Certain information is incorporated into this report by reference. Information about internal control and risk management systems relating to the financial reporting process can be found on page 13.

Information about share capital is shown in note 25 on page 71. The Bank is a wholly owned subsidiary of LBG, which holds all of the Bank's issued ordinary share capital.

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

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

Emissions
LBG, for which the Bank and Group are a part, has voluntarily reported greenhouse gas emissions (scope 1, 2 and 3) and environmental performance since 2009, and since 2013 this has been reported in line with the requirements of the Companies Act 2006 and its applicable regulations. The full details of LBG's greenhouse gas emissions, intensity ratio, carbon emissions, global energy use and energy efficiency can be found on page 131 of the LBG Annual Report and Accounts for 2021.

Employees
The Group employed an average of 954 colleagues (note 7) during 2021 (2020: 1,132). This represents colleagues based in Singapore, the USA, Germany and the Crown Dependencies. Organisational changes in the Crown Dependencies business account for the movement in the average number of colleagues year on year. Information concerning the employees of Lloyds Banking Group is available in the LBG's 2021 Annual Report and Accounts.

As part of LBG, the Bank is committed to creating an inclusive and diverse organisation where colleagues with disabilities or long-term health conditions feel valued and supported to reach their full potential. The Bank supports colleagues who have disclosed a disability in a range of ways. The Bank ensures full and fair consideration to applications from people with disabilities, and offers bespoke training, career development, promotions and adjustments for colleagues and applicants with disabilities, including those who became disabled while employed. This has been recognised through LBG holding the Business Disability Forum Gold Standard accreditation and retaining Disability Confident Leader status from the Department for Work and Pensions, which recognise the inclusive culture of LBG, and the support provided to our colleagues identified as having a disability including those who became disabled while employed.

Significant contracts
The Group has a shared service contract with Lloyds Bank plc for the provision of services (note 7).

Details of related party transactions are set out in note 30.

Streamlined Energy and Carbon Reporting
The Bank has taken advantage of the exemption from Streamlined Energy and Carbon Reporting (SECR) reporting requirements in its own Directors' Report as it is covered by the Lloyds Banking Group SECR report given in the Lloyds Banking Group plc 2021 Annual Report and Accounts, available at http://www.lloydsbankinggroup.com/investors/financial-downloads.html.

Statement of directors' responsibilities
The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors are required to prepare the Bank's financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006.

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and of the profit or loss of the Bank for that period. In preparing these financial statements, the Directors are required to properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; provide additional disclosures when compliance with the specific requirements in international accounting standards in conformity with the requirements of the Companies Act 2006 are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and make an assessment of the Bank's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank 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 Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the financial statements is placed on the website www.lloydsbankinggroup.com/investors/financial-downloads.html. The Directors are responsible for the maintenance and integrity of all information relating to the Bank on that website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the current Directors who are in office as at the date of this report, and whose names and functions are listed on page 19 of this annual report, confirm that, to the best of his or her knowledge:

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

Independent auditors 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 which the Group's and Bank's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Group's and Bank's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

Deloitte LLP were appointed by the Board as auditors of the Bank on 14 May 2021 to fill a casual vacancy and then on 23 June 2021 at the Bank's annual general meeting. Their re-appointment will be proposed at the Bank's next annual general meeting.

The financial statements were approved by the Board and signed on its behalf by:

Julienne Daglish

Julienne C Daglish
Director
24 March 2022

Lloyds Bank Corporate Markets plc
Registered in England & Wales
Company number 10399850

Current Directors

Executive Directors:

Eduardo J Stock da Cunha Chief *Executive Officer*

Julienne C Daglish *Chief Financial Officer*

Non-Executive Directors:

Lord Lupton CBE *Chair*

Eve A Henrikson

Emma L Lawrence

Andrew J McIntyre

John S W Owen *Senior Independent Director*

Carla Antunes-da-Silva

Forward looking statements

This document contains certain forward looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Bank Corporate Markets plc together with its subsidiaries (the Group) and its current goals and expectations. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements.

Words such as, without limitation, 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'deliver', 'endeavour', 'prospects', 'optimistic' and similar expressions or variations on these expressions are intended to identify forward looking statements.

These statements concern or may affect future matters, including but not limited to: projections or expectations of the Group's future financial position, including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; the Group's ESG targets and/or commitments; statements of plans, objectives or goals of the Group or its management and other statements that are not historical fact; expectations about the impact of COVID-19; and statements of assumptions underlying such statements.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future.

Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements include, but are not limited to: general economic and business conditions in the UK and internationally; market related risks, trends and developments; risks concerning borrower and counterparty credit quality; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; volatility in credit markets; volatility in the price of our securities; any impact of the transition from IBORs to alternative reference rates; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's or Lloyds Banking Group plc's credit ratings; the ability to derive cost savings and other benefits including, but without limitation, as a result of any acquisitions, disposals and other strategic transactions; inability to capture accurately the expected value from acquisitions; potential changes in dividend policy; the ability to achieve strategic objectives; insurance risks; management and monitoring of conduct risk; exposure to counterparty risk; credit rating risk; tightening of monetary policy in jurisdictions in which the Group operates; instability in the global financial markets, including within the Eurozone, and as a result of ongoing uncertainty following the exit by the UK from the European Union (EU) and the effects of the EU-UK Trade and Cooperation Agreement; political instability including as a result of any UK general election and any further possible referendum on Scottish independence; operational risks; conduct risk; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural pandemic (including but not limited to the COVID-19 pandemic) and other disasters; inadequate or failed internal or external processes or systems; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; risks relating to sustainability and climate change (and achieving climate change ambitions), including the Group and/or Lloyds Banking Group plc's ability along with the government and other stakeholders to measure, manage and mitigate the impacts of climate change effectively; changes in laws, regulations, practices and accounting standards or taxation; changes to regulatory capital or liquidity requirements and similar contingencies; assessment related to resolution planning requirements; the policies and actions of governmental or regulatory authorities or courts together with any resulting impact on the future structure of the Group; failure to comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations; failure to prevent or detect any illegal or improper activities; projected employee numbers and key person risk; increased labour costs; assumptions and estimates that form the basis of our financial statements; the impact of competitive conditions; and exposure to legal, regulatory or competition proceedings, investigations or complaints. A number of these influences and factors are beyond the control of the Group or Lloyds Banking Group plc. Please refer to the Base Prospectus for the Group's Euro Medium Term Note Programme and the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks.

Lloyds Banking Group plc may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc to third parties, including financial analysts.

Except as required by any applicable law or regulation, the forward-looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document whether as a result of new information, future events or otherwise. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANK CORPORATE MARKETS PLC

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Lloyds Bank Corporate Markets plc (the 'Bank') and its subsidiaries (the 'Group' or 'LBCM') give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB);
- the Bank financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise the:

- the consolidated income statement;
- the consolidated and Bank statements of comprehensive income for the year;
- the consolidated and Bank balance sheets;
- the consolidated and Bank statements of changes in equity;
- the consolidated and Bank cash flow statements; and
- Notes 1 to 39 to the financial statements, which include the accounting principles and policies.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law, United Kingdom adopted international accounting standards and IFRSs as issued by the IASB. The financial reporting framework that has been applied in the preparation of the Bank financial statements is applicable law and United Kingdom adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006.

2. Basis for opinion

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

We are independent of the Group and the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and Bank for the year are disclosed in note 8 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the Group or the Bank.

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

3. Audit scope, approach, and execution

Key audit matters	The key audit matter that we identified in the current year were: i. Expected credit losses (Group and Bank); ii. Valuation of certain complex and illiquid financial instruments held at fair value (Group and Bank); and iii. IT systems that impact financial reporting (Group and Bank).
Materiality	Overall materiality used for the Group consolidated financial statements was £34.8 million, which was determined on the basis of net assets. Overall materiality used for the Bank's financial statements was £34.8 million, which was determined on the basis of net assets and capped at Group materiality.
Scoping	Our audit scope covers 95% of the Group's revenue, 94% of the Group's profit before tax, 99% of the Group's total assets, and 99% of the Group's total liabilities.

First year audit transition

This is the first year we have been appointed as auditors to the Group. We undertook a number of transitional procedures to prepare for the audit including establishing our independence from the Group which involved ceasing a number of commercial relationships and banking arrangements and changing the financial arrangements for our partners and over 3,000 staff who are in the audit division at Deloitte, or who work on the LBCM audit. We used the time prior to commencing our audit to meet with Group leadership and non-executive directors to gain an understanding of the business, its issues and the environment in which it operates.

We became independent of the Group and commenced our audit planning on 1 January 2020. From June 2020, we attended all Audit Committee meetings, initially in an observer capacity, and continued to meet regularly with the Group leadership, non-executive directors and the Group's main regulators. We worked alongside the former auditor, reviewed their working papers and shadowed some of their meetings to gain an understanding of the Group's processes, their audit risk assessment, and the controls on which they relied for the purposes of issuing their audit opinion.

Throughout 2020, we held regular meetings of audit partners and senior staff who would be responsible for undertaking the audits in the significant components of the Group. The main purpose of these meetings were to outline our audit approach, including discussing possible significant audit risks, the use of analytics in assessing significant and non-significant risks, to discuss testing approaches, and to brief our teams on the Group's key processes, systems and structure. During these meetings, we also heard directly from the Group on the changes impacting the business to inform our audit planning and risk assessment.

Our audit approach
We structured our approach to the audit to reflect how the Group is organised as well as ensuring our audit was both effective and risk-focused. Our audit approach can be summarised into the following areas that enabled us to obtain the evidence required to form an opinion on the Group and Bank financial statements:

- **Risk assessment and audit planning.** We instructed partners for each of the Group's three components, as well as identified partners to lead areas requiring significant audit judgement including the expected credit loss. These partners met regularly with management to understand business strategy, accounting judgements and estimations and other matters which arose during the year that could have impacted the Group's financial reporting. Our risk assessment was further informed by detailed analytics as well as other quantitative and qualitative audit procedures, including consideration of matters such as the impact of the global pandemic and climate change on the account balances, disclosures and group practices;
- **Audit work executed at a component level.** We have identified components based on the Group's operating segments and their geographical location. The following components were subject to audit procedures; the overseas component teams based in US, Singapore and Crown Dependencies. The Group audit team was in active dialogue throughout the audit with the component audit teams responsible for the audit work under the direction and supervision of the Group audit team. This included determining whether the work was planned and performed in accordance with the overall Group audit strategy and the requirements of our Group audit instructions to the components. Government work-from-home orders and travel restrictions in force during the year required our teams to work and communicate remotely. We were able to satisfy ourselves that our oversight and supervision was appropriate through increased video-conferencing, direct reviews of work completed within the UK, remote reviews over video-conferencing for work performed overseas, and we have continued to attend virtually the planning and clearance meetings of components to engage with local management.
- **Audit procedures undertaken at a Group level and at the Bank.** In addition to the above, we also performed audit work on the Group and Bank financial statements, including the consolidation of the Group's results, and the preparation of the financial statements in addition to the Group's entity level and oversight controls relevant to financial reporting. All components greater than 10% of the total Group's assets or 10% of the Group's total liabilities were included in our audit scope. The components not covered by our audit scope are subject to analytical procedures to confirm our conclusion that there were no significant risks of material misstatement in the aggregated financial information.
- **Internal controls testing approach.** We tested internal controls over financial reporting where our scoping and risk assessment determined those controls to be relevant to the audit. This included testing of general IT controls, process level controls and entity level controls at the Group level.
- **The impact of climate change on out audit.** In planning our audit, we have considered the impact of climate change on the Group's operations and subsequent impact on its financial statements. The Group sets out its assessment of the potential impact on page 8 of the Strategic report section of the Annual Report

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

- process for identifying affected operations, including the governance and controls over this process, and the subsequent effect on the financial reporting for the Group; and
- long-term strategy to respond to climate change risks as they evolve including the effect on the Group's forecasts.

Our audit work has involved:

- challenging the completeness of the physical and transition risks identified and considered in the Group's climate risk assessment and the conclusion that there is no material impact of climate change risk on the current year financial reporting;
- assessing the Group's qualitative loan sector analysis, which supports the Group's conclusion that there is no material financial statement impact of climate risk on expected credit losses; and
- assessing disclosures in the annual report, and challenging the consistency between the financial statements and the remainder of the annual report.

We have not been engaged to provide assurance over the accuracy of climate change disclosures set out at page 8 in the Annual Report. As part of our audit procedures we are required to read and consider these disclosures to consider whether they are materially inconsistent with the financial statements or knowledge obtained in the audit and we did not identify any material inconsistencies as a result of these procedures.

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

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

- using our knowledge of the Group and Bank, the financial services industry, the financial services regulatory environment and the general economic environment to identify inherent risks in the business model and how such risks might affect the financial resources or ability to continue operations over the going concern period;
- making enquiries of Group management about the assumptions, including growth rate and expected credit loss projections, used in their going concern assumption, and assessing the reasonableness of those assumptions and historical forecasting accuracy;
- supported by Prudential Risk specialists, reading the most recent ICAAP and ILAAP submissions, considered management's capital and liquidity projections, evaluating the results of management's stress testing, and challenging key assumptions and methods used in the stress testing;
- considering the Group's operational resilience;
- reading industry data, Bank of England reports and other external information to determine if it provided corroborative or contradictory evidence in relation to the Group's assumptions;
- reviewing correspondence and meeting with prudential and conduct regulators to assess whether there are any matters that may impact the going concern assessment; and
- evaluating the Group's disclosures on going concern against the requirements of IAS 1.

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

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

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Expected credit losses (Group and Bank)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
Refer to notes 3, 13 and 34 in the financial statements The Group has recognised £17 million of expected credit losses ("ECL") at 31 December 2021. The determination of ECL consists of a number of assumptions that require judgement and involves complex impairment modelling. The key areas we identified as having the most significant level of management judgement were in respect of: – Multiple Economic Scenarios (MES); and – Credit ratings and loans assessed individually.	
Multiple economic scenarios Multiple economic scenarios The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. The Group's Economic specialist team develops the future economic scenarios. Firstly, a base case forecast is produced based on a set of conditioning assumptions, which are designed to reflect the Group's best view of future events. A full distribution of economic scenarios around this base case is produced using a Monte Carlo simulation and scenarios within that distribution are ranked using estimated relationships with industry-wide historical loss data. Four scenarios are derived from the distribution as averages of constituent modelled scenarios around the 15th, 75th and 95th percentiles of the distribution corresponding to an upside, a downside and a severe downside, respectively. The upside, the base case and the downside scenarios are weighted at 30% and the severe downside at 10%. These four scenarios are then used as key assumptions in the determination of the ECL allowance. The development of these multiple economic scenarios is a complex process requiring significant audit effort albeit the Group's macroeconomic scenarios have historically been consistent with external benchmarks and market data and management follows a consistent and well-established process for producing scenarios. The global pandemic has increased the uncertainty of the conditioning assumptions used to develop the base case and, to account for this, the Group has recognised an adjustment to their multiple economic scenarios model to account for the significant downside uncertainties.	Working with our Economic specialist team and modelling specialists, we performed the following procedures: – Tested the controls over the generation of the multiple economic scenarios including those over the Group's governance processes to determine the base case, different scenarios and the weightings applied to each scenario; – Challenged and evaluated economic forecasts in the base scenario such as the unemployment rate, commercial real estate price growth, Bank rate and Gross Domestic Product in UK through comparison to an independent economic outlook, external analysts and market data; – Challenged and evaluated the appropriateness of the methodology applied to generate alternative macroeconomic scenarios, including associated weightings, and assumptions within; – Tested whether the methodology has been appropriately reflected in the model code by producing an independent version of the model generating alternative macroeconomic scenarios and reconciling its outputs to the Group's model; – Tested the completeness and accuracy of the data used by the model; – Challenged the appropriateness of the weightings applied to each of the scenarios based on publicly available data; and – Evaluated the adequacy of disclosures in respect of significant judgements and sources of estimation uncertainty including macroeconomic scenarios.

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Credit ratings and loans assessed individually

The Group's ECL is calculated on a collective basis for performing loans, being those in stage 1 and 2, and on an individual basis for larger impaired loan in stage 3 with a net exposure of £25million.

The collective provision is determined using impairment models. The models use a number of judgements to calculate a probability weighted ECL estimate by applying appropriate probability of default, estimated exposure at default and taking account of collateral held or other loss mitigants, discounted using the effective interest rate. The key driver of the probability of default, and, therefore, the staging of the Group's exposures, is the credit risk rating. The determination of these credit risk ratings is performed on a counterparty basis for larger exposures by a credit officer and involves judgement and consideration of multiple sources of information.

Therefore, we focused our work on testing these credit risk ratings feeding the collective models which required significant audit effort given this was determined on a counterparty basis as well as on the appropriateness of the methodology applied.

For individual assessments of larger exposure in stage 3, the judgements in determining provisions and where we focused our work on are the:

- completeness and appropriateness of the potential workout and restructuring scenarios identified;
- probability assigned to each identified potential workout and restructuring scenario; and
- valuation assumptions used in determining the workout and restructuring scenarios.

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We tested the controls across the process to determine the ECL provisions including:

- the determination of credit risk ratings;
- the allocation into stages, particularly the assessment of a significant change in credit risk;
- model governance and arithmetical accuracy of provision calculations;
- data accuracy and completeness; and
- recognition and calculation of post-model adjustments.

We performed the following audit procedures over:

Expected credit losses determined through impairment models:

- Independently assessed the credit rating and tested whether a significant increase in credit risk had occurred to result in a stage 2 classification against IFRS 9 criteria;
- Assessed the appropriateness of the model methodologies, approach and assumptions, including those used in developing the internal model adjustments ('IMAs') and post model adjustments ('PMAs');
- Tested the completeness and accuracy of key data used; and
- Performed a recalculation of the IFRS 9 collective provision.

Expected credit losses assessed individually:

- Assessed the exposure to determine if they met the definition of credit impaired;
- Performed independent assessments to determine the appropriateness of recovery scenarios and associated cash flows, including considerations of climate risks on recoveries;
- Evaluated valuations, including management's use of valuation specialists; and
- Independently assessed and challenged the completeness of workout and restructuring scenarios identified and weightings applied.

Adequacy of disclosure where we:

- assessed whether the disclosures appropriately address the uncertainty which exists in determining the ECL.

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Key observations communicated to the Audit Committee

We are satisfied that the ECL are reasonable and recognised in accordance with the requirements of IFRS 9. The calculations are based on appropriate methodologies using reasonable modelled assumptions, including IMAs and PMAs addressing model shortcomings. Overall ECL levels are reasonable.

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<table>
<tr><th colspan="2">Valuation of certain complex and illiquid financial instruments held at fair value (Group and the Bank)</th></tr>
<tr><th>Key audit matter description</th><th>How the scope of our audit responded to the key audit matter</th></tr>
<tr><td>Refer to notes 3, 11, 12, 32 and 34 in the financial statements

Financial instruments are classified as Level 1, 2 or 3 in accordance with IFRS 13 'Fair value measurement'.

The Group has £1.9 billion of complex and illiquid financial instruments classified as Level 3 at 31 December 2021. The fair value of complex and illiquid financial instruments, involves significant judgement. The extent of judgment applied by the Group in valuing the Group's financial investments varies with the nature of assets held, the markets in which they are traded, and the valuation methodology applied.

The Group holds a number of portfolios of level 3 financial instruments consisting of long-dated derivative contracts, illiquid debt securities and loans to customers. The valuation of these Level 3 financial instruments uses complex valuation models as these are without readily determinable market values which involved considerable judgment by management.

We also consider these judgements to be at risk of management bias, giving rise to a potential risk of fraud.</td><td>We tested the controls over the valuation of financial instruments, including controls over independent price verification, model validation and model review controls.

We utilised our valuation specialists in our audit of the valuation of the level 3 portfolios and we performed the following procedures:

– Challenged the appropriateness of derivative contracts and illiquid debt and loans valuation methodologies;
– Calculated an independent valuation for a sample of modelled Level 3 financial instruments and compared results of our independent estimates with those of the Group;
– Evaluated the consistency and appropriateness of inputs and assumptions over time, challenging both significant movements and non-movements where we expected change;
– Performed a stand back assessment of the appropriateness of the assumptions, models and input data used in the valuation of Level 3 financial instruments to evaluate contradictory evidence; and
– Assessed the adequacy of financial instruments disclosures included in Note 32.</td></tr>
<tr><td colspan="2">Key observation communicated to the Audit Committee

We are satisfied that the valuation of complex and illiquid financial instruments is reasonable and in accordance with IFRS 13.</td></tr>
</table>

IT systems that impact financial reporting (Group and Bank)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
The Group's IT environment is inherently complex as it supports a broad range of banking and insurance products and facilitates the processing of a significant volume of transactions. The IT systems within the Group form a critical component of the Group's financial reporting activities and impact all account balances with a reliance on automated and IT dependent manual controls. Due to the significant reliance on IT systems, effective General IT Controls (GITCs) are critical to allow reliance to be placed on the completeness and accuracy of financial data and the integrity of automated system functionality (e.g. system calculations). We identified the IT systems that impact financial reporting as a key audit matter because of the: – Pervasive reliance on complex technology that is integral to the operation of key business processes and financial reporting; – Reliance on technology which continues to develop in line with the business strategy, such as the increase in the use of automation across the Group and increasing reliance on third parties; and – Importance of the IT controls in maintaining an effective control environment. A key interdependency exists between the ability to rely on IT controls and the ability to rely on financial data, system configured automated controls and system reports. IT controls, in the context of our audit scope, primarily relate to privileged access at the infrastructure level, user access security at the application level and change control.	Our IT audit scope tested the Group's IT controls over information systems deemed relevant to the audit based on the financial data, system configured automated controls and/or key financial reports that reside within it. We used IT specialists to support our evaluation of the risks associated with IT in the following areas: – General IT Controls, including user access and change management controls; – Key financial reports and system configured automated controls; and – Cyber security risk assessment. Where deficiencies in the IT control environment were identified, our risk assessment procedures included an assessment of those deficiencies to determine the impact on our audit plan. Where relevant, the audit plan was adjusted to mitigate the unaddressed IT risk. Where we were able to identify and test appropriate mitigating controls over affected financial statement line items, our testing approach remained unchanged. In a limited number of areas, we adopted a non-controls reliance approach and we therefore performed additional substantive procedures.
Key observations communicated to the Audit Committee IT control deficiencies were identified in respect of privileged user access to IT infrastructure and in application user access management. The existence of these deficiencies in the year resulted in a heightened risk that data, reports and automated system functionality from the affected systems might not be reliable. Overall, in combination with business mitigating controls, we are satisfied that the Group's overall IT control environment appropriately supports the financial reporting process.	

6. Our application of materiality

6.1 Materiality

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

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

	Group financial statements	Bank financial statements
Materiality	£34.8 million (2020: £34.0 million)	£34.8 million (2020: £34.0 million), capped to the Group's materiality.

Basis for determining materiality	In determining our benchmark for materiality, we have considered the metrics used by investors and other users of the financial statements. We have determined net assets to be the most relevant to users of the financial statements. The Group's materiality represents 1% of net assets.	The Bank's materiality represents 1% of net assets.
Rationale for the benchmark applied	Given the importance of these measures to investors and users of the financial statements, we have used net assets as the primary benchmark for our determination of materiality. Net assets is a key metric within the financial statements on which the users, being the owner of the Group, lenders, and regulatory body tends to focus. Component materiality allocated across all four components range between £6.3 million and £20.6 million.	Given the importance of these measures to investors and users of the financial statements, we have used net assets as the primary benchmark for our determination of materiality. Net assets is a key metric within the financial statements on which the users, being the owner of the Bank, lenders, and regulatory body tends to focus.

6.2 Performance materiality

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

	Group financial statements	Bank financial statements
Performance materiality	60% of Group materiality – £20.9 million (2020: 75% of Group materiality - £25.5 million)	60% of Bank materiality – £20.9 million (2020: 75% of Group materiality - £25.5 million)
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: a. the current financial year being Deloitte LLP's first year auditing the Group and Bank financial statements; b. the quality of the control environment and whether we were able to rely on controls; c. degree of centralisation and commonality of controls and processes; d. the uncertain economic environment arising from the COVID-19 pandemic; e. the nature, volume and size of uncorrected misstatements arising in the previous audit; and f. the nature, volume and size of uncorrected misstatements that remain uncorrected in the current period.	

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.7 million (2020: £1.7 million), as well as any differences below this threshold, which in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. Other Information

The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information contained within the Annual Report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.	**We have nothing to report in this regard.**

8. Responsibilities of Directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Bank's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

9. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

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

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

Identifying and assessing potential risks related to irregularities

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

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

Audit response to risks identified

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

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

– reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
– enquiring of management, the Audit Committee and in-house legal counsel concerning actual and potential litigation and claims;
– performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
– reading minutes of meetings of those charged with governance, reviewing internal audit reports and correspondence with regulators including Prudential Regulation Authority and Financial Conduct Authority;
– in response to the risk associated with the recognition of Day 1 P&L, the difference between transaction price and the modelled fair value on transaction date, requires judgement in relation to the observability of key inputs, we challenged management's assessment of unobservability of key inputs and appropriateness of the accounting treatment used on a sample of trades; and
– in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

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

Report on other legal and regulatory requirements

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

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

– The information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

– The strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

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

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

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

13. Other matters which we are required to address

Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by shareholders at its annual general meeting on 23 June 2021 to audit the financial statements of Lloyds Bank Corporate Markets plc for the year ended 31 December 2021 and subsequent financial periods. The period of total uninterrupted engagement of the firm is accordingly one year.

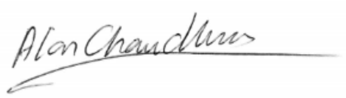
Consistency of the audit report with the additional report to the Audit Committee

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

14. Use of our report

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

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



Alan Chaudhuri (Senior Statutory Auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

24 March 2022

Lloyds Bank Corporate Markets plc

Consolidated income statement

for the year ended 31 December 2021

	Note	2021 £ million	2020 £ million
Interest income[1]		**356**	470
Interest expense[1]		**(169)**	(396)
Net interest income	4	**187**	74
Fee and commission income		**248**	218
Fee and commission expense		**(27)**	(27)
Net fee and commission income	5	**221**	191
Net trading income	6	**244**	279
Other operating expense		**(11)**	—
Other income		**454**	470
Total income		**641**	544
Operating expenses	7	**(414)**	(428)
Impairment gains / (losses)	9	**62**	(71)
Profit before tax		**289**	45
Tax expense	10	**(51)**	(1)
Profit for the year		**238**	44
Profit attributable to ordinary shareholders		**205**	4
Profit attributable to other equity holders		**33**	40
Profit for the year		**238**	44

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 2021

		The Group		The Bank	
		2021	2020	**2021**	2020
	Note	**£ million**	£ million	**£ million**	£ million
Profit for the year		**238**	44	**247**	9
Other comprehensive income					
Items that may subsequently be reclassified to profit or loss:					
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	26	**8**	(1)	**8**	(1)
Movements in cash flow hedging reserve, net of tax	26	**(153)**	49	**(153)**	49
Movements in foreign currency translation reserve, net of tax	26	**—**	1	**—**	4
Total other comprehensive (expense) income for the year, net of tax		**(145)**	49	**(145)**	52
Total comprehensive income for the year		**93**	93	**102**	61
Total comprehensive income attributable to ordinary shareholders		**60**	53	**69**	21
Total comprehensive income attributable to other equity holders		**33**	40	**33**	40
Total comprehensive income for the year		**93**	93	**102**	61

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

Balance sheets

as at 31 December 2021

		The Group		The Bank	
		2021	2020	2021	2020
	Note	£ million	£ million	£ million	£ million
Assets					
Cash and balances at central banks		**22,140**	23,369	**22,140**	23,369
Financial assets at fair value through profit or loss	11	**22,409**	20,926	**22,268**	20,841
Derivative financial instruments	12	**17,990**	21,757	**18,042**	21,818
Loans and advances to banks [2]		**2,354**	3,600	**2,333**	3,571
Loans and advances to customers[2]		**17,432**	14,256	**17,176**	13,993
Reverse repurchase agreements[2]		**5,044**	5,856	**5,044**	5,856
Debt securities		**229**	257	**229**	257
Due from fellow Lloyds Banking Group undertakings		**557**	1,118	**862**	1,218
Financial assets at amortised cost	13	**25,616**	25,087	**25,644**	24,895
Financial assets at fair value through other comprehensive income	15	**100**	149	**100**	149
Property, plant and equipment	16	**67**	78	**53**	61
Current tax recoverable		**16**	19	**14**	15
Deferred tax assets	22	**37**	19	**40**	18
Investment in subsidiary undertakings	17	**—**	—	**203**	223
Other assets	18	**324**	1,025	**317**	1,019
Total assets		**88,699**	92,429	**88,821**	92,408
Liabilities					
Deposits from banks[2]		**3,821**	5,601	**3,821**	5,601
Customer deposits[2]		**26,967**	25,497	**26,553**	25,061
Repurchase agreements[2]		**1,019**	—	**1,019**	—
Due to fellow Lloyds Banking Group undertakings		**3,442**	3,283	**3,920**	3,659
Financial liabilities at fair value through profit or loss	19	**16,582**	15,815	**16,582**	15,815
Derivative financial instruments	12	**15,572**	21,233	**15,571**	21,233
Debt securities in issue	20	**16,644**	15,602	**16,644**	15,602
Other liabilities[2]	21	**461**	1,008	**444**	985
Current tax liabilities		**5**	—	**8**	—
Deferred tax liabilities	22	**—**	38	**—**	35
Other provisions[2]	23	**13**	37	**10**	35
Subordinated liabilities	24	**684**	686	**684**	686
Total liabilities		**85,210**	88,800	**85,256**	88,712
Equity					
Share capital	25	**120**	120	**120**	120
Other reserves	26	**(64)**	81	**(62)**	83
Retained profits[1]	27	**2,651**	2,646	**2,725**	2,711
Ordinary shareholders' equity		**2,707**	2,847	**2,783**	2,914
Other equity instruments	28	**782**	782	**782**	782
Total equity		**3,489**	3,629	**3,565**	3,696
Total equity and liabilities		**88,699**	92,429	**88,821**	92,408

1 The Bank recorded a profit after tax for the year of £247 million (2020: £9 million).

2 Restated, see note 1.

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

The Directors approved the financial statements on 24 March 2022.

Eduardo J Stock da Cunha
Director

Julienne Daglish

Julienne C Daglish
Director

Lloyds Bank Corporate Markets plc

Statements of changes in equity

for the year ended 31 December 2021

The Group	Attributable to ordinary shareholders: Share capital £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Total £ million
At 1 January 2020	120	32	3,342	3,494	782	4,276
Comprehensive income						
Profit for the year	—	—	4	4	40	44
Other comprehensive income						
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	—	(1)	—	(1)	—	(1)
Movements in cash flow hedging reserve, net of tax	—	49	—	49	—	49
Movements in foreign currency translation reserve, net of tax	—	1	—	1	—	1
Total other comprehensive income	—	49	—	49	—	49
Total comprehensive income	—	49	4	53	40	93
Transactions with owners						
Dividends (note 29)	—	—	(700)	(700)	—	(700)
Distributions on other equity instruments	—	—	—	—	(40)	(40)
Total transactions with owners	—	—	(700)	(700)	(40)	(740)
At 31 December 2020	120	81	2,646	2,847	782	3,629
Comprehensive (expense) income						
Profit for the year	**—**	**—**	**205**	**205**	**33**	**238**
Other comprehensive income						
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	**—**	**8**	**—**	**8**	**—**	**8**
Movements in cash flow hedging reserve, net of tax	**—**	**(153)**	**—**	**(153)**	**—**	**(153)**
Movements in foreign currency translation reserve, net of tax	**—**	**—**	**—**	**—**	**—**	**—**
Total other comprehensive (expense) income	**—**	**(145)**	**—**	**(145)**	**—**	**(145)**
Total comprehensive (expense) income[1]	**—**	**(145)**	**205**	**60**	**33**	**93**
Transactions with owners						
Dividends (note 29)	**—**	**—**	**(200)**	**(200)**	**—**	**(200)**
Distributions on other equity instruments	**—**	**—**	**—**	**—**	**(33)**	**(33)**
Total transactions with owners	**—**	**—**	**(200)**	**(200)**	**(33)**	**(233)**
At 31 December 2021	**120**	**(64)**	**2,651**	**2,707**	**782**	**3,489**

1 Total comprehensive income attributable to owners of the parent was £93 million (2020: £93 million).

Further details of movements in the Group's share capital and reserves are provided in notes 25, 26, 27 and 28.

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

Statements of changes in equity

for the year ended 31 December 2021

	Attributable to ordinary shareholders					
The Bank	**Share capital £ million**	**Other reserves £ million**	**Retained profits £ million**	**Total £ million**	**Other equity instruments £ million**	**Total £ million**
At 1 January 2020	120	31	3,442	3,593	782	4,375
Comprehensive income						
(Loss) profit for the year	—	—	(31)	(31)	40	9
Other comprehensive income						
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	—	(1)	—	(1)	—	(1)
Movements in cash flow hedging reserve, net of tax	—	49	—	49	—	49
Movements in foreign currency translation reserve, net of tax	—	4	—	4	—	4
Total other comprehensive income	—	52	—	52	—	52
Total comprehensive income	—	52	(31)	21	40	61
Transactions with owners						
Dividends (note 29)	—	—	(700)	(700)	—	(700)
Distributions on other equity instruments	—	—	—	—	(40)	(40)
Total transactions with owners	—	—	(700)	(700)	(40)	(740)
At 31 December 2020	120	83	2,711	2,914	782	3,696
Comprehensive (expense) income						
Profit for the year			**214**	**214**	**33**	**247**
Other comprehensive income						
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	**—**	**8**	**—**	**8**	**—**	**8**
Movements in cash flow hedging reserve, net of tax	**—**	**(153)**	**—**	**(153)**	**—**	**(153)**
Movements in foreign currency translation reserve, net of tax	**—**	**—**	**—**	**—**	**—**	
Total other comprehensive (expense) income		**(145)**		**(145)**		**(145)**
Total comprehensive income[1]	**—**	**(145)**	**214**	**69**	**33**	**102**
Transactions with owners						
Dividends (note 29)	**—**	**—**	**(200)**	**(200)**	**—**	**(200)**
Distributions on other equity instruments	**—**	**—**	**—**	**—**	**(33)**	**(33)**
Total transactions with owners	**—**	**—**	**(200)**	**(200)**	**(33)**	**(233)**
At 31 December 2021	**120**	**(62)**	**2,725**	**2,783**	**782**	**3,565**

1 Total comprehensive income attributable to owners of the parent was £102 million (2020: £61 million).

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

Cash flow statements

for the year ended 31 December 2021

		The Group		The Bank	
		2021	2020[1]	**2021**	2020[1]
	Note	**£ million**	£ million	**£ million**	£ million
Profit before tax		**289**	45	**293**	3
Adjustments for:					
Change in operating assets	36(A)	**328**	(5,659)	**180**	(5,672)
Change in operating liabilities	36(B)	**(3,629)**	13,571	**(3,502)**	13,537
Non-cash and other items	36(C)	**(125)**	171	**(152)**	177
Tax paid		**(41)**	(63)	**(38)**	(51)
Net cash (used in)/provided by operating activities		**(3,178)**	8,065	**(3,219)**	7,994
Cash flows from investing activities					
Purchase of financial assets		**(85)**	(35)	**(85)**	(35)
Proceeds from sale and maturity of financial assets		**138**	202	**138**	202
Purchase of fixed assets		**(7)**	(24)	**(1)**	(20)
Dividends received from subsidiaries		**—**	—	**44**	57
Net cash (used in)/provided by investing activities		**46**	143	**96**	204
Cash flows from financing activities					
Dividends paid to ordinary shareholders	29	**(200)**	(700)	**(200)**	(700)
Distributions on other equity instruments		**(33)**	(40)	**(33)**	(40)
Interest paid on subordinated liabilities		**(16)**	(23)	**(16)**	(23)
Net cash (used in)/provided by financing activities		**(249)**	(763)	**(249)**	(763)
Effect of exchange rate changes on cash and cash equivalents		**69**	(169)	**69**	(167)
Change in cash and cash equivalents		**(3,312)**	7,276	**(3,303)**	7,268
Cash and cash equivalents at beginning of year		**26,370**	19,094	**26,341**	19,073
Cash and cash equivalents at end of year	36(D)	**23,058**	26,370	**23,038**	26,341

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

1 Restated - See note 1

Note 1: Basis of preparation

The consolidated financial statements of Lloyds Bank Corporate Markets plc and its subsidiary undertakings have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. The financial statements have also been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB).

The financial information has been prepared under the historical cost convention, as modified by the revaluation financial assets measured at fair value through other comprehensive income, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. The Directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements. In reaching this assessment, the Directors have considered the implications of the short-term impacts of the COVID-19 pandemic and climate change upon the Group's performance and projected funding and capital position. The Directors have also taken into account the impact of further stress scenarios.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2021 and which have not been applied in preparing these financial statements are given in note 38.

In 2019 the Group adopted IFRS 16 and amendments to IAS 12 and early-adopted the hedge accounting amendments *Interest Rate Benchmark Reform* issued by the IASB. In 2021, the Group has adopted the *Interest Rate Benchmark Reform* Phase 2 amendments issued by the IASB. These amendments require that changes to expected future cash flows that both arise as a direct result of IBOR Reform and are economically equivalent to the previous cash flows are accounted for as a change to the effective interest rate with no adjustment to the asset's or liability's carrying value; no immediate gain or loss is recognised. The new requirements also provide relief from the requirements to discontinue hedge accounting as a result of amending hedge documentation if the changes are required solely as a result of IBOR Reform. The amendments do not have a material impact on the Group's comparatives, which have not been restated. Note 34 provides further details and disclosures related to IBOR.

The 2020 comparative cashflow statement has been restated to correct the treatment of the non-cash item movements on the net cash provided by operating activities and reallocation of purchases and sales on financial assets from operating activities to investing activities. These corrections have no impact on the closing cash positions but the following impact on the underlying lines within the cashflow statement, for the Group: net cash provided by operating activities decreased by £167 million from £8,232 million to £8,065 million with a corresponding £167 million increase on net cash used in investing activities to £143 million. And for the bank: net cash provided by operating activities decreased by £167 million from £8,161 million to £7,994 million with a corresponding £167 million increase on net cash used in investing activities to £204 million.

The following changes have been made to the presentation of the Group's assets and liabilities on the face of the balance sheet:

– Reverse repurchase agreements with banks and customers are shown separately from loans and advances to banks and loans and advances to customers respectively; and repurchase agreements with customers are shown separately from customer deposits
– Other provisions are shown separately from other liabilities

There has been no change in the basis of accounting for any of the underlying transactions. Comparatives have been presented on a consistent basis for all of the above.

The 2020 interest income and interest expense balances have been restated to reflect £26 million negative interest correctly in the interest expense line, there has been no impact to net interest income.

Note 2: Accounting policies

The accounting policies are set out below. These accounting policies have been applied consistently.

(A) Consolidation

The assets, liabilities and results of Group undertakings are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include subsidiaries. Details of the Group's subsidiaries and related undertakings are given on page 111.

(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.

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

(B) Revenue recognition

(1) Net interest income

Interest income and expense are recognised in the income statement using the effective interest method for all interest-bearing financial instruments, except for those classified at fair value through profit or loss. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument to the gross carrying amount of the financial asset (before adjusting for expected credit losses) or to the amortised cost of the financial liability, including early redemption fees, other fees, and premiums and discounts that are an integral part of the overall return. In the case of financial assets that are purchased or originated credit-impaired, the effective interest rate is the rate that discounts the estimated future cash flows to the amortised cost of the instrument. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account. Interest income from non-credit impaired financial assets is recognised by applying the effective interest rate to the gross carrying amount of the asset; for credit impaired financial assets, the effective interest rate is applied to the net carrying amount after deducting the allowance for expected credit losses. Impairment policies are set out in (F) below.

Note 2: Accounting policies (continued)

(2) Fee and commission income and expense
Fees and commissions receivable which are not an integral part of the effective interest rate are recognised as income as the Group fulfils its performance obligations. The Group receives certain fees in respect of its asset finance business where the performance obligations are typically fulfilled towards the end of the customer contract; these fees are recognised in income on this basis. Where it is unlikely that the loan commitments will be drawn, loan commitment fees are recognised in fee and commission income over the life of the facility, rather than as an adjustment to the effective interest rate for loans expected to be drawn. Incremental costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

(3) Other
Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to trading income are set out in (C)(3) below; those relating to leases are set out in (H)(1) below.

(C) Financial assets and liabilities
On initial recognition, financial assets are classified as measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the Group's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Group's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare. Equity investments are measured at fair value through profit or loss unless the Group elects at initial recognition to account for the instruments at fair value through other comprehensive income. For these instruments, principally strategic investments, dividends are recognised in profit or loss but fair value gains and losses are not subsequently reclassified to profit or loss following derecognition of the investment.

The Group initially recognises loans and advances, deposits, debt securities in issue and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of securities and other financial assets and trading liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either: substantially all of the risks and rewards of ownership have been transferred; or the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

(1) Financial instruments measured at amortised cost
Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest. Financial assets measured at amortised cost are predominantly loans and advances to customers and banks together with certain debt securities used by the Group to manage its liquidity. Loans and advances are initially recognised when cash is advanced to the borrower at fair value inclusive of transaction costs. Interest income is accounted for using the effective interest method (see (B) above).

Financial liabilities are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value.

(2) Financial assets measured at fair value through other comprehensive income
Financial assets that are held to collect contractual cash flows and for subsequent sale, where the assets' cash flows represent solely payments of principal and interest, are recognised in the balance sheet at their fair value, inclusive of transaction costs. Interest calculated using the effective interest method and foreign exchange gains and losses on assets denominated in foreign currencies are recognised in the income statement. All other gains and losses arising from changes in fair value are recognised directly in other comprehensive income, until the financial asset is either sold or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement other than in respect of equity shares, for which the cumulative revaluation amount is transferred directly to retained profits. The Group recognises a charge for expected credit losses in the income statement (see (F) below). As the asset is measured at fair value, the charge does not adjust the carrying value of the asset, it is reflected in other comprehensive income.

(3) Financial instruments measured at fair value through profit or loss
Financial assets are classified at fair value through profit or loss where they do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income. All derivatives are carried at fair value through profit or loss. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 32(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

Derivatives embedded in a financial asset are not considered separately; the financial asset is considered in its entirety when determining whether its cash flows are solely payments of principal and interest. Derivatives embedded in financial liabilities are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

Trading securities, which are debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains, do not meet these criteria and are also measured at fair value through profit or loss. Financial assets measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses together with interest coupons and dividend income are recognised in the income statement within net trading income.

Financial liabilities are measured at fair value through profit or loss where they are trading liabilities and are recognised in the balance sheet at their fair value. Fair value gains and losses are recognised in the income statement within net trading income in the period in which they occur.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices, respectively, which include the expected effects of potential changes to laws and regulations, risks associated with climate change and other factors. If the market is not active the Group establishes a fair value by using valuation techniques. The fair values of derivative financial instruments are adjusted where appropriate to reflect credit risk (via credit valuation adjustments (CVAs), debit valuation adjustments (DVAs) and funding valuation adjustments (FVAs)), market liquidity and other risks.

Note 2: Accounting policies (continued)

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

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense. Securities which carry a discretionary coupon and have no fixed maturity or redemption date are classified as other equity instruments. Interest payments on these securities are recognised as distributions from equity in the period in which they are paid. An exchange of financial liabilities on substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The difference between the carrying amount of a financial liability extinguished and the new financial liability is recognised in profit or loss together with any related costs or fees incurred.

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

(5) Sale and repurchase agreements (including securities lending and borrowing)
Securities sold subject to repurchase agreements (repos) continue to be recognised on the balance sheet where substantially all of the risks and rewards are retained. Funds received for repos carried at fair value are included within trading liabilities. Conversely, securities purchased under agreements to resell (reverse repos), where the Group does not acquire substantially all of the risks and rewards of ownership, are measured at amortised cost or at fair value. Those measured at fair value are recognised within trading securities. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

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

(D) Hedge accounting
As permitted by IFRS 9, the Group continues to apply the requirements of IAS 39 to its hedging relationships.

Changes in the fair value of all derivative instruments, other than those in effective cash flow hedging relationships, are recognised immediately in the income statement. As noted in (1) and (2) below, the change in fair value of a derivative in an effective cash flow or net investment hedging relationship is allocated between the income statement and other comprehensive income.

Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item, the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship is tested both at inception and throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued. Note 12 provides details of the types of derivatives held by the Group and presents separately those designated in hedge relationships.

Where there is uncertainty arising from interest rate benchmark reform, the Group assumes that the interest rate benchmark on which the hedged cash flows and/or the hedged risk are based, or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform. The Group does not discontinue a hedging relationship during the period of uncertainty arising from the interest rate benchmark reform solely because the actual results of the hedge are not highly effective.

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

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

(E) Offset
Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of offset and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Cash collateral on exchange traded derivative transactions is presented gross unless the collateral cash flows are always settled net with the derivative cash flows. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

(F) Impairment of financial assets
The impairment charge/release in the income statement reflects the change in expected credit losses, including those arising from fraud. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets (other than equity investments) measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. Expected credit losses are calculated as an unbiased and probability-weighted estimate using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held, repayments, or other mitigants of loss and including the impact of discounting using the effective interest rate.

Note 2: Accounting policies (continued)

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk since origination, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk since initial recognition are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit-impaired are allocated to Stage 3. Some Stage 3 assets are subject to individual rather than collective assessment. Such cases are subject to a risk-based impairment sanctioning process, and these are reviewed and updated at least quarterly, or more frequently if there is a significant change in the credit profile. The collective assessment of impairment aggregates financial instruments with similar risk characteristics, such as whether the facility is revolving in nature or secured and the type of security against financial assets.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. In determining whether there has been a significant increase in credit risk, the Group uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings together with qualitative indicators such as watchlists and other indicators of historical delinquency, credit weakness or financial difficulty. The use of internal credit ratings and qualitative indicators ensures alignment between the assessment of staging and the Group's management of credit risk which utilises these internal metrics within distinct retail and commercial portfolio risk management practices. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. The use of a payment holiday in and of itself has not been judged to indicate a significant increase in credit risk, with the underlying long-term credit risk deemed to be driven by economic conditions and captured through the use of forward-looking models. These portfolio-level models are capturing the anticipated volume of increased defaults and therefore an appropriate assessment of staging and expected credit loss. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit-impaired. Default is considered to have occurred when there is evidence that the customer is experiencing financial difficulty which is likely to affect significantly the ability to repay the amount due. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Group uses this 90 day backstop for all its products. Key differences between Stage 3 balances and non-performing loans relate to the cure periods applied to forbearance exposures. The use of payment holidays is not considered to be an automatic trigger of regulatory default and therefore does not automatically trigger Stage 3. Days past due will also not accumulate on any accounts that have taken a payment holiday including those already past due.

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until the credit risk has improved such that it no longer represents a significant increase since origination (for a return to Stage 1), or the loan is no longer credit-impaired (for a return to Stage 2). On renegotiation the gross carrying amount of the loan is recalculated as the present value of the renegotiated or modified contractual cash flows, which are discounted at the original effective interest rate. Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value.

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

(G) Property, plant and equipment

Property, plant and equipment (other than investment property) is included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows: the shorter of 50 years and the remaining period of the lease for freehold/long and short leasehold premises; the shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease for leasehold improvements; 10 to 20 years for fixtures and furnishings; and 2 to 8 years for other equipment and motor vehicles.

The assets' residual values and useful lives are reviewed, taking into account considerations such as potential changes to legislation, including those that are climate-related, as well as other factors, 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 assessing the recoverable amount of assets the Group considers the effects of potential or actual changes in legislation, customer behaviour, climate-related risks and other factors. 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.

(H) Leases

Under IFRS 16, a lessor is required to determine whether a lease is a finance or operating lease. A lessee is not required to make this determination.

(1) As lessor

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

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

Note 2: Accounting policies (continued)

(2) As lessee

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Assets and liabilities arising from a lease are initially measured on a present value basis. The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the Group's incremental borrowing rate appropriate for the right-of-use asset arising from the lease and the liability recognised within other liabilities.

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of twelve months or less. Low-value assets comprise IT equipment and small items of office furniture.

(I) Taxation

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it. The tax consequences of the Group's dividend payments (including distributions on other equity instruments), if any, are charged or credited to the statement in which the profit distributed originally arose.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or other relevant tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are remeasured as required to reflect current information.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

(J) Foreign currency translation

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

The results and financial position of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows: the assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date; and the income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions, in which case income and expenses are translated at the dates of the transactions.

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

(K) Provisions and contingent liabilities

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

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

Provision is made for expected credit losses in respect of irrevocable undrawn loan commitments and financial guarantee contracts (see (F) above).

Note 2: Accounting policies (continued)

(L) Share capital
Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds. Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid.

(M) 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 an original maturity of less than three months.

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

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

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

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

Allowance for expected credit losses

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

These judgements and estimates are subject to significant uncertainty.

The Group recognises an allowance for expected credit losses (ECLs) for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets (other than equity investments) measured at fair value through other comprehensive income and certain loan commitment and financial guarantee contracts. At 31 December 2021, the Group's expected credit loss allowance was £17 million (2020: £83 million), of which £11 million (2020: £50 million) was in respect of drawn balances; and the Bank's expected credit loss allowance was £17 million (2020: £82 million), of which £11 million (2020: £49 million) was in respect of drawn balances.

The calculation of the Group's expected credit loss allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Group to make a number of judgements, assumptions and estimates. The most significant are set out below.

Definition of default
The probability of default (PD) of an exposure, both over a 12-month period and over its lifetime, is a key input to the measurement of the ECL allowance. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The definition of default adopted by the Group is described in note 2(F) Impairment of financial assets.

Lifetime of an exposure
A range of approaches, segmented by product type, has been adopted by the Group to estimate a product's expected life. These include using the full contractual life and taking into account behavioural factors such as early repayments, extensions and refinancing. Changes to the assumed expected lives of the Group's assets could impact the ECL allowance recognised by the Group. The assessment of SICR and corresponding lifetime loss, and the PD, of a financial asset deemed to be Stage 2, or Stage 3, is dependent on its expected life.

Significant increase in credit risk
Performing assets are classified as either Stage 1 or Stage 2. An ECL allowance equivalent to 12 months' expected losses is established against assets in Stage 1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been a SICR since initial recognition. Credit-impaired assets are transferred to Stage 3 with a lifetime expected losses allowance. The Group uses both quantitative and qualitative indicators to determine whether there has been a SICR for an asset.

A doubling of PD with a minimum increase in PD of 1 percentage point and a resulting change in the underlying grade is treated as a SICR. The Group uses the internal credit risk classification and watchlist as qualitative indicators to identify a SICR. The Group does not use the low credit risk exemption in its staging assessments.

All financial assets are assumed to have suffered a SICR if they are more than 30 days past due. Financial assets are classified as credit-impaired if they are 90 days past due.

A Stage 3 asset that is no longer credit-impaired is transferred back to Stage 2 as no cure period is applied to Stage 3. If an exposure that is classified as Stage 2 no longer meets the SICR criteria, which in some cases capture customer behaviour in previous periods, it is moved back to Stage 1.

The setting of precise trigger points combined with risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance. The Group monitors the effectiveness of SICR criteria on an ongoing basis.

Generation of multiple economic scenarios
The estimate of expected credit losses is required to be based on an unbiased expectation of future economic scenarios. The approach used to generate the range of future economic scenarios depends on the methodology and judgements adopted. The Group's approach is to start

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

from a defined base case scenario, used for planning purposes, and to generate alternative economic scenarios around this base case. The base case scenario is a conditional forecast underpinned by a number of conditioning assumptions that reflect the Group's best view of key future developments. If circumstances appear likely to materially deviate from the conditioning assumptions, then the base case scenario is updated.

The base case scenario is central to a range of future economic scenarios generated by simulation of an economic model, for which the same conditioning assumptions apply as in the base case scenario. These scenarios are ranked by using estimated relationships with industry-wide historical loss data. With the base case already pre-defined, three other scenarios are identified as averages of constituent scenarios located around the 15th, 75th and 95th percentiles of the distribution. The full distribution is therefore summarised by a practical number of scenarios to run through ECL models representing an upside, the base case, and a downside scenario weighted at 30 per cent each, together with a severe downside scenario weighted at 10 per cent. The scenario weights represent the distribution of economic scenarios and not subjective views on likelihood. The inclusion of a severe downside scenario with a smaller weighting ensures that the non-linearity of losses in the tail of the distribution is adequately captured. The Group does not apply any reversion techniques within scenario generation, noting that data after the five-year forecast period shown has a relatively immaterial effect on the ECL provision.

A forum under the chairmanship of the LBG Chief Economist meets at least quarterly to review and, if appropriate, recommend changes to the method by which economic scenarios are generated, for approval by the Group Chief Financial Officer and Group Chief Risk Officer. While no material changes were made to the model in 2021, the forum identified the need to consider an alternative approach to address interest rate risks not captured within the downside scenarios. The forum recommended that a non-modelled severe downside scenario was evaluated for potential incremental losses. This was considered in the Islands Mortgages calibration approach but no judgement was considered necessary due to the low additional losses anticipated for this portfolio.

Base case and MES economic assumptions

The Group's base case economic scenario has been revised in light of the continuing impact of the COVID-19 pandemic, intensifying global inflation pressures, and a shift towards a more restrictive stance of monetary policy by central banks. The Group's updated base case scenario built in three key conditioning assumptions. First, the current wave of COVID-19 infections does not lead to a re-imposition of lockdown restrictions in the UK, although greater household caution is expected amid increased hospitalisation rates. Second, the rise in wholesale energy prices is passed on to consumers through a 50 per cent increase in retail energy prices in April 2022. Third, inflation expectations rise in response to increasing headline inflation but subsequently revert to levels consistent with the Bank of England's 2 per cent inflation target.

Based on these assumptions and incorporating the improved economic data in the fourth quarter, the Group's base case outlook is for a modest rise in the unemployment rate alongside a deceleration in residential and commercial property price growth, as the UK Bank Rate is raised in response to increasing inflationary pressures. Risks around this base case economic view lie in both directions and are partly captured by the generation of alternative economic scenarios described above. Uncertainties relating to key epidemiological developments, notably the possibility that a vaccine-resistant strain could emerge, are not specifically captured by these scenarios. These specific risks are recognised outside of the modelled scenarios with a central adjustment.

The Group has accommodated the latest available information at the reporting date in defining its base case scenario and generating alternative economic scenarios. The scenarios include forecasts for key variables in the fourth quarter of 2021, for which actuals may have since emerged prior to publication.

Scenarios by year

Key annual assumptions made by the Group are shown below. Gross domestic product is presented as an annual change, house price growth and commercial real estate price growth are presented as the growth in the respective indices within the period. UK Bank Rate and unemployment rate are averages for the period.

The key economic assumptions made by the Group averaged over a five-year period are also shown below. The five-year period reflects movements within the current reporting year such that 31 December 2021 reflects the five years 2021 to 2025. The prior year comparative data has been re-presented to align to the equivalent period, 2020 to 2024. The inclusion of the reporting year within the five-year period reflects the need to predict variables which remain unpublished at the reporting date, and recognises that credit models utilise both level and annual change in calculating ECL. The use of calendar years also maintains a comparability between tables disclosed.

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

At 31 December 2021	2021 %	2022 %	2023 %	2024 %	2025 %	2021-2025 average %
Upside						
UK Gross domestic product	7.1	4.0	1.4	1.3	1.4	3.0
UK Bank Rate	0.14	1.44	1.74	1.82	2.03	1.43
UK Unemployment rate	4.4	3.3	3.4	3.5	3.7	3.7
UK Commercial real estate price growth	12.4	5.8	0.7	1.0	(0.6)	3.7
US Gross domestic product	5.7	6.7	4.4	0.3	(0.5)	3.3
US Unemployment rate	5.3	3.4	2.6	3.4	4.6	3.9
Base case						
UK Gross domestic product	7.1	3.7	1.5	1.3	1.3	2.9
UK Bank Rate	0.14	0.81	1.00	1.06	1.25	0.85
UK Unemployment rate	4.5	4.3	4.4	4.4	4.5	4.4
UK Commercial real estate price growth	10.2	(2.2)	(1.9)	0.1	0.6	1.2
US Gross domestic product	5.5	3.6	2.5	2.0	1.5	3.0
US Unemployment rate	5.4	4.0	3.9	3.9	4.1	4.3
Downside						
UK Gross domestic product	7.1	3.4	1.3	1.1	1.2	2.8
UK Bank Rate	0.14	0.45	0.52	0.55	0.69	0.47
UK Unemployment rate	4.7	5.6	5.9	5.8	5.7	5.6
UK Commercial real estate price growth	8.6	(10.1)	(7.0)	(3.4)	(0.3)	(2.6)
US Gross domestic product	5.4	1.0	0.2	2.4	3.0	2.4
US Unemployment rate	5.4	4.7	5.9	5.8	5.2	5.4
Severe downside						
UK Gross domestic product	6.8	0.9	0.4	1.0	1.4	2.1
UK Bank Rate	0.14	0.04	0.06	0.08	0.09	0.08
UK Unemployment rate	4.9	7.7	8.5	8.1	7.6	7.3
UK Commercial real estate price growth	5.8	(19.6)	(12.1)	(5.3)	(0.5)	(6.8)
US Gross domestic product	5.2	(3.2)	(3.1)	3.9	5.7	1.6
US Unemployment rate	5.4	5.8	8.5	7.9	5.9	6.7
Probability-weighted						
UK Gross domestic product	7.0	3.4	1.3	1.2	1.3	2.8
UK Bank Rate	0.1	0.8	1.0	1.0	1.2	0.8
UK Unemployment rate	4.6	4.7	5.0	5.0	4.9	4.8
UK Commercial real estate price growth	9.9	(3.9)	(3.7)	(1.2)	(0.1)	0.1
US Gross domestic product	5.5	3.1	1.8	1.8	1.8	2.8
US Unemployment rate	5.4	4.2	4.6	4.7	4.7	4.7

Base case scenario by quarter[1] At 31 December 2021	First quarter 2021 %	Second quarter 2021 %	Third quarter 2021 %	Fourth quarter 2021 %	First quarter 2022 %	Second quarter 2022 %	Third quarter 2022 %	Fourth quarter 2022 %
UK Gross domestic product	(1.3)	5.4	1.1	0.4	0.1	1.5	0.5	0.3
UK Bank Rate	0.10	0.10	0.10	0.25	0.50	0.75	1.00	1.00
UK Unemployment rate	4.9	4.7	4.3	4.3	4.4	4.3	4.3	4.3
UK Commercial real estate price growth	(2.9)	3.4	7.5	10.2	8.4	5.2	0.9	(2.2)
US Gross domestic product	1.5	1.6	0.6	1.1	0.9	0.8	0.7	0.5
US Unemployment rate	6.2	5.9	5.1	4.2	4.1	4.0	3.9	3.9

1. Gross domestic product presented quarter on quarter and commercial real estate growth presented year on year - i.e. from the equivalent quarter the previous year. Bank Rate is presented end quarter.

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

At 31 December 2020	2020 %	2021 %	2022 %	2023 %	2024 %	2020-2024 average %
Upside						
UK Gross domestic product	(10.5)	3.7	5.7	1.7	1.5	0.3
UK Bank Rate	0.10	1.14	1.27	1.20	1.21	0.98
UK Unemployment rate	4.3	5.4	5.4	5.0	4.5	5.0
UK Commercial real estate price growth	(4.6)	9.3	3.9	2.1	0.3	2.1
US Gross domestic product	(3.4)	8.0	5.1	0.2	(0.6)	1.8
US Unemployment rate	8.3	5.7	3.8	4.3	5.3	5.5
Base case						
UK Gross domestic product	(10.5)	3.0	6.0	1.7	1.4	0.1
UK Bank Rate	0.10	0.10	0.10	0.21	0.25	0.15
UK Unemployment rate	4.5	6.8	6.8	6.1	5.5	5.9
UK Commercial real estate price growth	(7.0)	(1.7)	1.6	1.1	0.6	(1.1)
US Gross domestic product	(3.5)	3.9	2.6	2.0	1.8	1.3
US Unemployment rate	8.3	6.6	5.8	5.5	5.2	6.3
Downside						
UK Gross domestic product	(10.6)	1.7	5.1	1.4	1.4	(0.4)
UK Bank Rate	0.10	0.06	0.02	0.02	0.03	0.05
UK Unemployment rate	4.6	7.9	8.4	7.8	7.0	7.1
UK Commercial real estate price growth	(8.7)	(10.6)	(3.2)	(0.8)	(0.8)	(4.9)
US Gross domestic product	(3.7)	1.2	0.3	2.5	3.3	0.7
US Unemployment rate	8.3	7.3	7.7	7.2	6.2	7.3
Severe downside						
UK Gross domestic product	(10.8)	0.3	4.8	1.3	1.2	(0.8)
UK Bank Rate	0.10	0.00	0.00	0.01	0.01	0.02
UK Unemployment rate	4.8	9.9	10.7	9.8	8.7	8.8
UK Commercial real estate price growth	(11.0)	(21.4)	(9.8)	(3.9)	(0.8)	(9.7)
US Gross domestic product	(3.9)	(2.9)	(3.0)	3.8	5.9	(0.1)
US Unemployment rate	8.4	8.4	10.4	9.4	7.0	8.7
Probability-weighted						
UK Gross domestic product	(10.6)	2.6	5.5	1.6	1.4	(0.1)
UK Bank Rate	0.1	0.4	0.4	0.4	0.5	0.4
UK Unemployment rate	4.5	7.0	7.3	6.7	6.0	6.3
UK Commercial real estate price growth	(7.2)	(3.0)	(0.3)	0.3	(0.1)	(2.1)
US Gross domestic product	(3.6)	3.6	2.1	1.8	2.0	1.2
US Unemployment rate	8.3	6.7	6.2	6.0	5.7	6.6

Base case scenario by quarter[1] At 31 December 2020	First quarter 2020 %	Second quarter 2020 %	Third quarter 2020 %	Fourth quarter 2020 %	First quarter 2021 %	Second quarter 2021 %	Third quarter 2021 %	Fourth quarter 2021 %
UK Gross domestic product	(3.0)	(18.8)	16.0	(1.9)	(3.8)	5.6	3.6	1.5
UK Bank Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
UK Unemployment rate	4.0	4.1	4.8	5.0	5.2	6.5	8.0	7.5
UK Commercial real estate price growth	(5.0)	(7.8)	(7.8)	(7.0)	(6.1)	(2.9)	(2.2)	(1.7)
US Gross domestic product	(1.3)	(9.0)	7.4	0.9	0.8	0.8	0.8	0.7
US Unemployment rate	3.8	13.0	8.8	7.6	7.1	6.7	6.5	6.1

1. Gross domestic product presented quarter on quarter and commercial real estate growth presented year on year - i.e. from the equivalent quarter the previous year. Bank Rate is presented end quarter.

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

Economic assumptions – start to peak[1]

	At 31 December 2021				At 31 December 2020			
	Upside	Base case	Downside	Severe downside	Upside	Base case	Downside	Severe downside
	%	%	%	%	%	%	%	%
UK Gross domestic product	**12.6**	**12.3**	**11.4**	**7.6**	1.4	0.8	(1.7)	(3.0)
UK Bank Rate	**2.04**	**1.25**	**0.71**	**0.25**	1.44	0.25	0.10	0.10
UK Unemployment rate	**4.9**	**4.9**	**6.0**	**8.5**	6.5	8.0	9.3	11.5
UK Commercial real estate price growth	**20.9**	**10.2**	**8.6**	**6.9**	11.0	(2.7)	(2.7)	(2.7)
US Gross domestic product	**16.0**	**14.3**	**11.3**	**8.0**	9.4	6.5	3.8	0.5
US Unemployment rate	**6.2**	**6.2**	**6.2**	**8.8**	13.0	13.0	13.0	13.0

1 Reflects five year period from 2021 to 2025.

Economic assumptions – start to trough[1]

	At 31 December 2021				At 31 December 2020			
	Upside	Base case	Downside	Severe downside	Upside	Base case	Downside	Severe downside
	%	%	%	%	%	%	%	%
UK Gross domestic product	**(1.3)**	**(1.3)**	**(1.3)**	**(1.3)**	(21.2)	(21.2)	(21.2)	(21.2)
UK Bank Rate	**0.10**	**0.10**	**0.10**	**0.02**	0.10	0.10	0.01	0.00
UK Unemployment rate	**3.2**	**4.3**	**4.3**	**4.3**	4.0	4.0	4.0	4.0
UK Commercial real estate price growth	**0.8**	**0.8**	**(12.8)**	**(30.0)**	(6.9)	(9.0)	(22.2)	(39.9)
US Gross domestic product	**1.5**	**1.5**	**1.5**	**(3.7)**	(10.1)	(10.1)	(10.1)	(10.6)
US Unemployment rate	**2.6**	**3.9**	**4.3**	**4.4**	3.7	3.8	3.8	3.8

1 Reflects five year period from 2021 to 2025.

ECL sensitivity to economic assumptions

The table below shows the Group's ECL for the upside, base case, downside and severe downside scenarios. The stage allocation for an asset is based on the overall scenario probability-weighted PD and, hence, the staging of assets is constant across all the scenarios. In each economic scenario the ECL for individual assessments and post-model adjustments is constant reflecting the basis on which they are evaluated. Judgements applied through changes to inputs are reflected in the scenario sensitivities.

	Probability-weighted	Upside	Base case	Downside	Severe downside
	£m	£m	£m	£m	£m
At 31 December 2021	**17**	**13**	**16**	**18**	**26**
At 31 December 2020	83	51	71	102	159

The table below shows the Group's ECL for the upside, base case, downside and severe downside scenarios, with staging of assets based on each specific scenario probability of default. ECL applied through individual assessments and post-model adjustments is reported flat against each economic scenario, reflecting the basis on which they are evaluated. Judgements applied through changes to inputs are reflected in the scenario sensitivities. A probability-weighted scenario is not shown as this does not reflect the basis on which ECL is reported.

	Upside	Base case	Downside	Severe downside
	£m	£m	£m	£m
At 31 December 2021	**12**	**14**	**17**	**30**
At 31 December 2020	45	71	104	165

The table shows the percentage of assets that would be recorded in Stage 2 for the upside, base case, downside and severe downside scenarios, if stage allocation was based on each specific scenario.

	Upside	Base case	Downside	Severe downside
	%	%	%	%
At 31 December 2021	**0.2**	**0.2**	**0.3**	**2.8**
At 31 December 2020	0.4	1.6	2.1	3.3

Individual assessments

Stage 3 ECL in Commercial Banking is largely assessed on an individual basis using bespoke assessment of loss for each specific client. These assessments are carried out by the Business Support Unit based on detailed reviews and expected recovery strategies. While these assessments are based on the Group's latest economic view, the use of Group-wide multiple economic scenarios and weightings is not considered appropriate for these cases due to their individual characteristics. In place of this, a range of case-specific outcomes are considered with any alternative better or worse outcomes that carry a 25 per cent likelihood taken into account in establishing a probability-weighted ECL. At 31 December 2021 individually assessed provisions for the Group were £1 million (2020: £1 million) which reflected a range of £nil to £1 million (2020: £1 million to £2 million), based on the range of alternative outcomes considered.

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

Application of judgement in adjustments to modelled ECL

Impairment models fall within the Group's model risk framework with model monitoring, periodic validation and back testing performed on model components (i.e. probability of default, exposure at default and loss given default). Limitations in the Group's impairment models or data inputs may be identified through the ongoing assessment and validation of the output of the models. In these circumstances, management make appropriate adjustments to the Group's allowance for impairment losses to ensure that the overall provision adequately reflects all material risks. These adjustments are determined by considering the particular attributes of exposures which have not been adequately captured by the impairment models and range from changes to model inputs and parameters, at account level, through to more qualitative post-model adjustments.

Judgements are not typically assessed under each distinct economic scenario used to generate ECL, but instead are applied on the basis of final modelled ECL which reflects the probability-weighted view of all scenarios. All adjustments are reviewed quarterly and are subject to internal review and challenge, including by the Audit Committee, to ensure that amounts are appropriately calculated and that there are specific release criteria identified.

The COVID-19 pandemic and the various support measures that have been put in place have resulted in an economic environment which differs significantly from the historical economic conditions upon which the impairment models have been built. As a result there has been a greater need for management judgements to be applied alongside the use of models. At 31 December 2021 management judgement resulted in additional ECL allowances totalling £6 million (2020: £50 million). This comprises judgements added due to COVID-19 and other judgements not directly linked to COVID-19 but which have increased in size during the pandemic. The table below analyses total ECL allowance by portfolio, separately identifying the amounts that have been modelled, those that have been individually assessed and those arising through the application of management judgement.

	Modelled ECL	Individually assessed	Judgements due to COVID-19[1]	Other judgements	Total ECL
	£m	£m	£m	£m	£m
At 31 December 2021	**10**	**1**	**6**	**—**	**17**
At 31 December 2020	32	1	50	—	83

1 Judgements introduced to address the impact that COVID-19 and resulting interventions have had on the Group's economic outlook and observed loss experience, which have required additional model limitations to be addressed.

Judgements due to COVID-19

Post model adjustments have been raised to reflect uncertainty in the near term economic outlook and limitations in the models in dealing with this uncertainty but the impact on staging of assets has not been reflected.

Economic impacts not captured by models: £5 million (2020: £20 million)

A further management adjustment to increase ECL by £5 million is incorporated, to reflect the additional uncertainty of economic forecasts. This qualitative overlay is a management judgement to ensure the overall provision adequately reflects the current material risks; considering the range of the quarterly provision release, review of trends and provision coverage.

Fair value of financial instruments

Key estimate: Interest rate spreads and interest rate volatility

At 31 December 2021, the carrying value of the Group's financial instrument assets held at fair value was £40,499 million (2020: £42,832 million), and its financial instrument liabilities held at fair value was £32,154 million (2020: £37,048 million). The carrying value of the Bank's financial instrument assets held at fair value was £40,410 million (2020: £42,808 million) and financial instrument liabilities held at fair value was £32,153 million (2020: £37,048 million).

The Group's valuation control framework and a description of level 1, 2 and 3 financial assets and liabilities is set out in note 32(2). The valuation techniques for level 3 financial instruments involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. In addition, in line with market practice, the Group applies credit, debit and funding valuation adjustments in determining the fair value of its uncollateralised derivative positions. A description of these adjustments is set out in note 32.

Note 4: Net interest income

	2021 £m	2020 £m
Interest income:		
Loans and advances to banks and reverse repurchase agreements[4]	**37**	99
Loans and advances to customers and reverse repurchase agreements[4]	**318**	367
Debt securities	**1**	2
Financial assets held at amortised cost	**356**	468
Financial assets at fair value through other comprehensive income	**—**	2
Total interest income[1]	**356**	470
Interest expense:		
Deposits from banks and repurchase agreements[4]	**(12)**	(39)
Customer deposits and repurchase agreements[4]	**(84)**	(178)
Debt securities in issue[2]	**(55)**	(154)
Lease liabilities	**(2)**	(3)
Subordinated liabilities	**(16)**	(22)
Total interest expense[3]	**(169)**	(396)
Net interest income	**187**	74

1 Includes £1 million (2020: £1 million) of interest income on liabilities with negative interest rates and £9 million (2020: £5 million) in respect of interest income on finance leases.

2 The impact of the Group's hedging arrangements is included on this line, of which a credit of £44 million (2020: credit of £23 million) transferred from the cash flow hedging reserve (see note 26).

3 Includes £23 million (2020: £26 million) of interest expense on assets with negative interest rates.

4 Restated - See note 1

Included within interest income is £nil (2020: £1 million) in respect of credit-impaired financial assets.

Note 5: Net fee and commission income

	2021 £m	2020 £m
Fee and commission income:		
Current accounts	**4**	4
Credit and debit card fees	**5**	2
Commercial banking and treasury fees	**237**	199
Private banking and asset management	**—**	5
Other fees and commissions	**2**	8
Total fee and commission income	**248**	218
Fee and commission expense	**(27)**	(27)
Net fee and commission income	**221**	191

Fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 4. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 6.

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

At 31 December 2021, the Group held on its balance sheet £4 million (31 December 2020: £6 million) in respect of services provided to customers and £nil (31 December 2020: £nil) in respect of amounts received from customers for services to be provided after the balance sheet date.

Note 6: Net trading income

	2021 £m	2020 £m
Foreign exchange	**98**	95
Securities and other gains (see below)	**146**	184
Net trading income	**244**	279

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

	2021 £m	2020 £m
Net income arising on assets and liabilities mandatorily held at fair value through profit or loss:		
Financial instruments held for trading	**178**	147
Other financial instruments mandatorily held at fair value through profit or loss:		
Debt securities, loans and advances	**(29)**	34
Equity shares	**(3)**	3
	146	184
Securities and other gains	**146**	184

Note 7: Operating expenses

	2021 £m	2020 £m
Staff costs:		
Salaries	**(156)**	(149)
Social security costs	**(14)**	(14)
Pensions and other post-retirement benefit schemes	**(13)**	(13)
Restructuring costs	**(4)**	(5)
Other staff costs	**(9)**	(6)
	(196)	(187)
Management charges payable	**(155)**	(186)
Depreciation and amortisation	**(15)**	(16)
Premises and equipment	**(13)**	(6)
Communications and data processing	**(15)**	(11)
Professional fees	**(5)**	(6)
Other operating expenses	**(15)**	(16)
Total operating expenses	**(414)**	(428)

Services are received by the Group from other parts of the Lloyds Banking Group via a shared service provision model. This is governed via Intra Group Agreement (IGA) contracts and includes the provision of services supporting the business, operations and support functions. Management charges payable were paid to Lloyds Bank plc in respect of these services. UK-based colleagues are employed through other Lloyds Banking Group companies and costs recharged via the IGA. The terms of the contract are negotiated and renewable to ensure market rate expense for services provided.

The Group had an average of 954 (2020: 1,132) employees during the year based in Singapore, the USA, Germany and the Crown Dependencies.

Note 8: Auditors' remuneration

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

	2021 £m	2020 £m
Fees payable for the audit of the Bank's current year Annual Report	**2.1**	2.1
Fees payable for other services:		
Audit of the Bank's subsidiaries pursuant to legislation	**0.4**	0.4
Other services supplied pursuant to legislation	**0.2**	0.2
Other services – audit-related fees	**0.4**	0.1
Total fees payable to the Bank's auditors	**3.1**	2.8

1 Deloitte LLP became the Group's statutory auditor in 2021. PricewaterhouseCoopers LLP was the statutory auditor during 2020.

Audit fees payable in respect of the statutory audit of Group entities totalled £2.5 million (2020: £2.5 million) and non-audit fees, as defined by the Financial Reporting Council's Ethical Guidance, totalled £0.6 million (2020: £0.3 million).

The following types of services are included in the categories listed above:

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings.

Audit related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements, for example acting as reporting accountants in respect of debt prospectuses required by the Listing Rules.

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

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants.

The Group has procedures that are designed to ensure auditor independence for the Group and all of its subsidiaries, including prohibiting certain non-audit services. All audit and non-audit assignments must be pre-approved by the Groups audit committee (the Audit Committee) on an individual engagement basis; for certain types of non-audit engagements where the fee is 'de minimis' the Audit Committee has pre-approved all assignments subject to confirmation by management. On a quarterly basis, the Audit Committee receives and reviews a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

Note 9: Impairment

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2021				
Impact of transfers between stages	**—**	**6**	**—**	**6**
Other changes in credit quality	**19**	**14**	**—**	**33**
Additions and repayments	**14**	**10**	**—**	**24**
Methodology and model changes	**—**	**—**	**—**	**—**
Other items	**—**	**—**	**(1)**	**(1)**
	33	**24**	**(1)**	**56**
Total impairment	**33**	**30**	**(1)**	**62**
In respect of:				
Loans and advances to banks and reverse repurchase agreements	**1**	**—**	**—**	**1**
Loans and advances to customers and reverse repurchase agreements	**19**	**18**	**(1)**	**36**
Financial assets at amortised cost	**20**	**18**	**(1)**	**37**
Impairment charge on drawn balances	**20**	**18**	**(1)**	**37**
Loan commitments and financial guarantees	**13**	**12**	**—**	**25**
Total impairment	**33**	**30**	**(1)**	**62**

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2020				
Impact of transfers between stages	1	(14)	—	(13)
Other changes in credit quality	(37)	(16)	(9)	(62)
Additions and repayments	(20)	(3)	(1)	(24)
Methodology and model changes	13	—	—	13
Other items	—	—	15	15
	(44)	(19)	5	(58)
Total impairment	(43)	(33)	5	(71)
In respect of:				
Loans and advances to banks and reverse repurchase agreements	(1)	—	—	(1)
Loans and advances to customers and reverse repurchase agreements	(20)	(19)	5	(34)
Financial assets at amortised cost	(21)	(19)	5	(35)
Impairment charge on drawn balances	(21)	(19)	5	(35)
Loan commitments and financial guarantees	(22)	(14)	—	(36)
Total impairment	(43)	(33)	5	(71)

The Group's impairment charge comprises the following items:

Impact of transfers between stages
The net impact on the impairment charge of transfers between stages.

Other changes in credit quality
Changes in loss allowance as a result of movements in risk parameters that reflect changes in customer quality, but which have not resulted in a transfer to a different stage. This also contains the impact on the impairment charge as a result of write-offs and recoveries, where the related loss allowances are reassessed to reflect ultimate realisable or recoverable value.

Additions and repayments
Expected loss allowances are recognised on origination of new loans or further drawdowns of existing facilities. Repayments relate to the reduction of loss allowances resulting from the repayments of outstanding balances that have been provided against.

Methodology and model changes
Increase or decrease in impairment charge as a result of adjustments to the models used for expected credit loss calculations; either as changes to the model inputs or to the underlying assumptions, as well as the impact of changing the models used.

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

Note 10: Tax expense

(A) Analysis of tax expense for the year

	2021 £m	2020 £m
UK corporation tax:		
Current tax on profit for the year	**(19)**	(6)
Adjustments in respect of prior years	**2**	(2)
	(17)	(8)
Foreign tax:		
Current tax on profit for the year	**(32)**	(7)
Adjustments in respect of prior years	**(1)**	—
	(33)	(7)
Current tax expense	**(50)**	(15)
UK deferred tax:		
Origination and reversal of temporary differences	**(3)**	(1)
Adjustments in respect of prior years	**2**	1
	(1)	—
Foreign deferred tax:		
Origination and reversal of temporary differences	**(7)**	10
Adjustments in respect of prior years	**7**	4
	—	14
Deferred tax credit	**(1)**	14
Tax expense	**(51)**	(1)

(B) Factors affecting the tax expense for the year

The UK corporation tax rate for the year was 19.0 per cent (2020: 19.0 per cent). An explanation of the relationship between tax expense and accounting profit is set out below:

	2021 £m	2020 £m
Profit before tax	**289**	45
UK corporation tax thereon	**(55)**	(9)
Impact of surcharge on banking profits	**(5)**	(2)
Non-deductible costs: bank levy	**(3)**	(5)
Other non-deductible costs	**(4)**	(1)
Non-taxable income	**6**	9
Tax relief on coupons on other equity instruments	**6**	8
Remeasurement of deferred tax due to rate changes	**1**	—
Recognition of temporary differences that arise in prior year	**4**	6
Temporary differences not recognised	**—**	(3)
Differences in overseas tax rates	**(8)**	(2)
Other adjustments in respect of prior years	**6**	(3)
Other	**1**	1
Tax expense	**(51)**	(1)
Effective tax rate	**17.6%**	2.2%

Note 11: Financial assets at fair value through profit or loss

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Trading assets	**21,773**	20,262	**21,773**	20,262
Other financial assets mandatorily at fair value through profit or loss	**636**	664	**495**	579
Total financial assets at fair value through profit or loss	**22,409**	20,926	**22,268**	20,841

The assets are comprised as follows:

	The Group				The Bank			
	2021		2020		**2021**		2020	
	Trading assets	**Other financial assets mandatorily at fair value through profit or loss**	Trading assets	Other financial assets mandatorily at fair value through profit or loss	**Trading assets**	**Other financial assets mandatorily at fair value through profit or loss**	Trading assets	Other financial assets mandatorily at fair value through profit or loss
	£m	**£m**	£m	£m	**£m**	**£m**	£m	£m
Loans and advances to banks	**486**	**—**	229	—	**486**	**—**	229	—
Loans and advances to customers	**14,436**	**307**	12,766	353	**14,436**	**307**	12,766	353
Debt securities:								
Government securities	**6,580**	**—**	6,983	—	**6,580**	**—**	6,983	—
Bank and building society certificates of deposit	**—**	**122**	—	66	**—**	**—**	—	—
Asset-backed securities:								
Mortgage-backed securities	**12**	**—**	7	—	**12**	**—**	7	—
Other asset-backed securities	**3**	**—**	4	—	**3**	**—**	4	—
Corporate and other debt securities	**256**	**188**	273	223	**256**	**188**	273	223
	6,851	**310**	7,267	289	**6,851**	**188**	7,267	223
Treasury and other bills	**—**	**19**	—	19	**—**	**—**	—	—
Equity shares	**—**	**—**	—	3	**—**	**—**	—	3
Total	**21,773**	**636**	20,262	664	**21,773**	**495**	20,262	579

At 31 December 2021 £6,947 million (2020: £7,633 million) of financial assets at fair value through profit or loss of the Group and £6,947 million (2020: £7,633 million) of the Bank 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 34.

Note 12: Derivative financial instruments

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

The Group	2021 Contract/ notional amount £m	2021 Fair value assets £m	2021 Fair value liabilities £m	2020 Contract/ notional amount £m	2020 Fair value assets £m	2020 Fair value liabilities £m
Trading and other						
Exchange rate contracts:						
Spot, forwards and futures	**51,783**	**720**	**784**	55,793	947	1,057
Currency swaps	**374,551**	**3,176**	**2,722**	377,768	5,001	4,959
Options purchased	**5,045**	**371**	**—**	5,769	428	—
Options written	**5,660**	**—**	**428**	7,560	—	489
	437,039	**4,267**	**3,934**	446,890	6,376	6,505
Interest rate contracts:						
Interest rate swaps	**2,726,348**	**11,356**	**9,397**	4,433,732	12,594	11,784
Forward rate agreements	**6,416**	**1**	**1**	554,066	12	6
Options purchased	**19,047**	**1,641**	**—**	24,507	2,572	—
Options written	**18,571**	**—**	**1,497**	21,053	—	2,711
Futures	**211,003**	**22**	**13**	273,727	1	9
	2,981,385	**13,020**	**10,908**	5,307,085	15,179	14,510
Credit derivatives	**1,996**	**12**	**67**	2,228	22	55
Equity and other contracts	**6,339**	**684**	**660**	3,390	174	160
Total derivative assets/liabilities - trading and other	**3,426,759**	**17,983**	**15,569**	5,759,593	21,751	21,230
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**7,414**	**1**	**2**	7,700	1	—
	7,414	**1**	**2**	7,700	1	—
Derivatives designated as cash flow hedges:						
Interest rate swaps	**13,571**	**6**	**1**	9,750	5	3
	13,571	**6**	**1**	9,750	5	3
Total derivative assets/liabilities - hedging	**20,985**	**7**	**3**	17,450	6	3
Total recognised derivative assets/liabilities	**3,447,744**	**17,990**	**15,572**	5,777,043	21,757	21,233

Note 12: Derivative financial instruments (continued)

	2021			2020		
The Bank	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading and other						
Exchange rate contracts:						
Spot, forwards and futures	**51,783**	**720**	**784**	55,793	947	1,057
Currency swaps	**374,551**	**3,176**	**2,722**	377,768	5,001	4,959
Options purchased	**5,045**	**371**	**—**	5,769	428	—
Options written	**5,660**	**—**	**428**	7,560	—	489
	437,039	**4,267**	**3,934**	446,890	6,376	6,505
Interest rate contracts:						
Interest rate swaps	**2,726,461**	**11,408**	**9,396**	4,433,847	12,655	11,784
Forward rate agreements	**6,416**	**1**	**1**	554,066	12	6
Options purchased	**19,047**	**1,641**	**—**	24,507	2,572	—
Options written	**18,571**	**—**	**1,497**	21,053	—	2,711
Futures	**211,003**	**22**	**13**	273,727	1	9
	2,981,498	**13,072**	**10,907**	5,307,200	15,240	14,510
Credit derivatives	**1,996**	**12**	**67**	2,228	22	55
Equity and other contracts	**6,339**	**684**	**660**	3,390	174	160
Total derivative assets/liabilities - trading and other	**3,426,872**	**18,035**	**15,568**	5,759,708	21,812	21,230
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**7,414**	**1**	**2**	7,700	1	—
	7,414	**1**	**2**	7,700	1	—
Derivatives designated as cash flow hedges:						
Interest rate swaps	**13,571**	**6**	**1**	9,750	5	3
	13,571	**6**	**1**	9,750	5	3
Total derivative assets/liabilities - hedging	**20,985**	**7**	**3**	17,450	6	3
Total recognised derivative assets/liabilities	**3,447,857**	**18,042**	**15,571**	5,777,158	21,818	21,233

At 31 December 2021 £14,253 million of total recognised derivative assets of the Group (2020: £17,497 million) and £14,310 million of the Bank (2020: £17,558 million) and £12,096 million of total recognised derivative liabilities of the Group and the Bank of (2020: £16,992 million) had a contractual residual maturity of greater than one year.

The notional amount of the contract does not represent the Group's exposure to credit risk, which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure; a large proportion of the Group's derivatives are held through exchanges such as London Clearing House and are collateralised through those exchanges. Further details are provided in note 34 Credit risk.

The Group holds derivatives as part of the following strategies:

- Customer driven, where derivatives are held as part of the provision of risk management products to Group customers
- To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value and cash flow hedge approaches as described in note 34.

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

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

Note 12: Derivative financial instruments (continued)

The Group and the Bank At 31 December 2021	**Maturity** Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	**1,113**	**—**	**1,044**	**4,110**	**1,147**	**7,414**
Average fixed interest rate	**2.92%**	**—**	**(0.52%)**	**0.20%**	**2.65%**	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	**—**	**125**	**886**	**10,040**	**2,520**	**13,571**
Average fixed interest rate	**—**	**0.49%**	**0.44%**	**0.28%**	**0.38%**	

The Group and the Bank At 31 December 2020	Maturity Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	—	—	575	5,076	2,049	7,700
Average fixed interest rate	—	—	0.40%	0.74%	1.37%	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	—	165	1,016	4,633	3,936	9,750
Average fixed interest rate	—	0.98%	0.65%	0.87%	1.06%	

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

The Group and the Bank At 31 December 2021	**Carrying amount of the hedging instrument** Contract/ notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness £m
Fair value hedges				
Interest rate				
Interest rate swaps	**7,414**	**1**	**2**	**(142)**
Cash flow hedges				
Interest rate				
Interest rate swaps	**13,571**	**6**	**1**	**(207)**

The Group and the Bank At 31 December 2020	Carrying amount of the hedging instrument Contract/ notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness £m
Fair value hedges				
Interest rate				
Interest rate swaps	7,700	1	—	121
Cash flow hedges				
Interest rate				
Interest rate swaps	9,750	5	3	80

All amounts are held within derivative financial instruments on the balance sheet.

Note 12: Derivative financial instruments (continued)

The Group's hedged items are as follows:

The Group and the Bank At 31 December 2021	Carrying amount of the hedged item Assets £m	Carrying amount of the hedged item Liabilities £m	Accumulated amount of fair value adjustment on the hedged item Assets £m	Accumulated amount of fair value adjustment on the hedged item Liabilities £m	Change in fair value of hedged item for ineffectiveness assessment £m	Cash flow hedging reserve Continuing hedges £m	Cash flow hedging reserve Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**—**	**7,461**	**—**	**77**	**141**		
Cash flow hedges							
Interest rate							
Customer loans[2]					**14**	**(28)**	**32**
Central bank balances[3]					**179**	**(104)**	**32**
Customer deposits[4]					**(2)**	**4**	**(5)**

The Group and the Bank At 31 December 2020	Carrying amount of the hedged item Assets £m	Carrying amount of the hedged item Liabilities £m	Accumulated amount of fair value adjustment on the hedged item Assets £m	Accumulated amount of fair value adjustment on the hedged item Liabilities £m	Change in fair value of hedged item for ineffectiveness assessment £m	Cash flow hedging reserve Continuing hedges £m	Cash flow hedging reserve Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	—	7,887	—	220	(123)		
Cash flow hedges							
Interest rate							
Customer loans[2]					(6)	31	(3)
Central bank balances[3]					(69)	116	—

1 Included within debt securities in issue.
2 Included within loans and advances to customers.
3 Included within cash and balances at central banks
4 Included within customer deposits.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is £nil (2020: £nil).

The cash flow hedge reserve in the previous table is calculated on a pre-deferred tax basis.

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

The Group and the Bank At 31 December 2021	Gain (loss) recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Amounts reclassified from reserves to income statement as: Hedged cash flows will no longer occur £m	Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m	Income statement line item that includes reclassified amount
Fair value hedges					
Interest rate					
Fixed rate issuance		**(1)**			
Cash flow hedges					
Interest rate					
Customer loans	**(25)**	**(2)**	**—**	**(27)**	**Interest income**
Central bank balances	**(187)**	**(10)**	**—**	**(21)**	**Interest income**
Customer deposits	**(1)**	**—**	**—**	**4**	**Interest expense**

Note 12: Derivative financial instruments (continued)

The Group and the Bank At 31 December 2020	Gain (loss) recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Amounts reclassified from reserves to income statement as: Hedged cash flows will no longer occur £m	Hedged item affected income statement £m	Income statement line item that includes reclassified amount
Fair value hedges					
Interest rate					
Fixed rate issuance		(2)			
Cash flow hedges					
Interest rate					
Customer loans	—	1	—	(4)	Interest income
Central bank balances	70	9	—	(19)	Interest income

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

There were no amounts reclassified from the cash flow hedging reserve in 2020 or 2021 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

Note 13: Financial assets at amortised cost

Year ended 31 December 2021

	Gross carrying amount				Allowance for expected credit losses			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
The Group	£m	£m	£m	£m	£m	£m	£m	£m
Loans and advances to banks and reverse repurchase agreements								
At 1 January 2021	5,262	—	—	5,262	2	—	—	2
Exchange and other adjustments[1]	(53)	—	—	(53)	—	—	—	—
Additions and repayments	(2,318)	—	—	(2,318)	—	—	—	—
Other changes in credit quality					(1)	—	—	(1)
Credit to the income statement					(1)	—	—	(1)
At 31 December 2021	2,891	—	—	2,891	1	—	—	1
Allowance for impairment losses	(1)	—	—	(1)				
Net carrying amount	2,890	—	—	2,890				
Loans and advances to customers and reverse repurchase agreements								
At 1 January 2021	18,082	379	39	18,500	26	20	2	48
Exchange and other adjustments[1]	(261)	(7)	—	(268)	—	—	(1)	(1)
Transfers to Stage 1	43	(42)	(1)	—	2	(2)	—	—
Transfers to Stage 2	(14)	14	—	—	—	—	—	—
Transfers to Stage 3	—	(3)	3	—	—	—	—	—
Impact of transfers between stages	29	(31)	2	—	(2)	—	—	(2)
					—	(2)	—	(2)
Other changes in credit quality					(8)	(13)	1	(20)
Additions and repayments	4,024	(294)	(11)	3,719	(11)	(3)	—	(14)
Methodology and model changes					—	—	—	—
Credit to the income statement					(19)	(18)	1	(36)
Advances written off			(1)	(1)			(1)	(1)
At 31 December 2021	21,874	47	29	21,950	7	2	1	10
Allowance for impairment losses	(7)	(2)	(1)	(10)				
Net carrying amount	21,867	45	28	21,940				
Debt securities								
At 1 January 2021	257	—	—	257	—	—	—	—
Exchange and other adjustments[1]	1	—	—	1	—	—	—	—
Additions and repayments	(29)	—	—	(29)	—	—	—	—
At 31 December 2021	229	—	—	229	—	—	—	—
Allowance for impairment losses	—	—	—	—				
Net carrying amount	229	—	—	229				
Due from fellow Lloyds Banking Group undertakings								
At 31 December 2021	557	—	—	557				
Allowance for impairment losses	—	—	—	—				
Net carrying amount	557	—	—	557				
Total financial assets at amortised cost	25,543	45	28	25,616				

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

Note 13: Financial assets at amortised cost (continued)

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

	Allowance for expected credit losses			
The Group	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Undrawn balances				
At 1 January 2021	**20**	**13**	**—**	**33**
Exchange and other adjustments[1]	**(1)**	**(1)**	**—**	**(2)**
Transfers to Stage 1	**4**	**(4)**	**—**	**—**
Transfers to Stage 2	**—**	**—**	**—**	**—**
Transfers to Stage 3	**—**	**—**	**—**	**—**
Impact of transfers between stages	**(4)**	**—**	**—**	**(4)**
	—	**(4)**	**—**	**(4)**
Other changes in credit quality	**(13)**	**(8)**	**—**	**(21)**
Credit to the income statement	**(13)**	**(12)**	**—**	**(25)**
At 31 December 2021	**6**	**—**	**—**	**6**

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

The Group's total impairment allowances were as follows:

	Allowance for expected credit losses			
The Group	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
In respect of:				
Loans and advances to banks and reverse repurchase agreements	**1**	**—**	**—**	**1**
Loans and advances to customers and reverse repurchase agreements	**7**	**2**	**1**	**10**
Financial assets at amortised cost	**8**	**2**	**1**	**11**
Provisions in relation to loan commitments and financial guarantees	**6**	**—**	**—**	**6**
Total	**14**	**2**	**1**	**17**

Note 13: Financial assets at amortised cost (continued)

Year ended 31 December 2020

	Gross carrying amount				Allowance for expected credit losses			
The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loans and advances to banks and reverse repurchase agreements								
At 1 January 2020	4,814	—	—	4,814	1	—	—	1
Exchange and other adjustments[1]	75	—	—	75	—	—	—	—
Additions and repayments	373	—	—	373	—	—	—	—
Other changes in credit quality					1	—	—	1
Charge to the income statement					1	—	—	1
At 31 December 2020	5,262	—	—	5,262	2	—	—	2
Allowance for impairment losses	(2)	—	—	(2)				
Net carrying amount	5,260	—	—	5,260				
Loans and advances to customers and reverse repurchase agreements								
At 1 January 2020	20,028	29	293	20,350	7	2	77	86
Exchange and other adjustments[1]	301	(74)	(222)	5	(1)	(1)	(9)	(11)
Transfers to Stage 1	3	(3)	—	—	2	(2)	—	—
Transfers to Stage 2	(339)	339	—	—	—	—	—	—
Transfers to Stage 3	(3)	(29)	32	—	—	—	—	—
Impact of transfers between stages	(339)	307	32	—	(2)	3	—	1
					—	1	—	1
Other changes in credit quality					7	16	(6)	17
Additions and repayments	(1,908)	117	(3)	(1,794)	13	2	1	16
Charge (credit) to the income statement					20	19	(5)	34
Advances written off			(61)	(61)			(61)	(61)
At 31 December 2020	18,082	379	39	18,500	26	20	2	48
Allowance for impairment losses	(26)	(20)	(2)	(48)				
Net carrying amount	18,056	359	37	18,452				
Debt securities								
At 1 January 2020	112	—	—	112	—	—	—	—
Exchange and other adjustments[1]	(4)	—	—	(4)	—	—	—	—
Additions and repayments	149	—	—	149	—	—	—	—
At 31 December 2020	257	—	—	257	—	—	—	—
Allowance for impairment losses	—	—	—	—				
Net carrying amount	257	—	—	257				
Due from fellow Lloyds Banking Group undertakings								
At 31 December 2020	1,118	—	—	1,118				
Allowance for impairment losses	—	—	—	—				
Net carrying amount	1,118	—	—	1,118				
Total financial assets at amortised cost	24,691	359	37	25,087				

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

Note 13: Financial assets at amortised cost (continued)

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

	Allowance for expected credit losses			
	Stage 1	Stage 2	Stage 3	Total
The Group	£m	£m	£m	£m
Undrawn balances				
At 1 January 2020	4	—	—	4
Exchange and other adjustments[1]	(6)	(1)	—	(7)
Transfers to Stage 1	—	—	—	—
Transfers to Stage 2	(1)	1	—	—
Transfers to Stage 3	—	—	—	—
Impact of transfers between stages	—	12	—	12
	(1)	13	—	12
Other changes in credit quality	23	1	—	24
Charge to the income statement	22	14	—	36
At 31 December 2020	20	13	—	33

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

The Group's total impairment allowances were as follows:

	Allowance for expected credit losses			
	Stage 1	Stage 2	Stage 3	Total
The Group	£m	£m	£m	£m
In respect of:				
Loans and advances to banks and reverse repurchase agreements	2	—	—	2
Loans and advances to customers and reverse repurchase agreements	26	20	2	48
Financial assets at amortised cost	28	20	2	50
Provisions in relation to loan commitments and financial guarantees	20	13	—	33
Total	48	33	2	83

Note 13: Financial assets at amortised cost (continued)

Year ended 31 December 2021

	Gross carrying amount				Allowance for expected credit losses			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
The Bank	£m	£m	£m	£m	£m	£m	£m	£m
Loans and advances to banks and reverse repurchase agreements								
At 1 January 2021	5,233	—	—	5,233	2	—	—	2
Exchange and other adjustments[1]	(53)	—	—	(53)	—	—	—	—
Additions and repayments	(2,310)	—	—	(2,310)	—	—	—	—
Other changes in credit quality					(1)	—	—	(1)
Credit to the income statement					(1)	—	—	(1)
At 31 December 2021	2,870	—	—	2,870	1	—	—	1
Allowance for impairment losses	(1)	—	—	(1)				
Net carrying amount	2,869	—	—	2,869				
Loans and advances to customers and reverse repurchase agreements								
At 1 January 2021	17,833	364	39	18,236	25	20	2	47
Exchange and other adjustments[1]	(261)	(6)	—	(267)	1	—	(1)	—
Transfers to Stage 1	38	(37)	(1)	—	2	(2)	—	—
Transfers to Stage 2	(10)	10	—	—	—	—	—	—
Transfers to Stage 3	—	(3)	3	—	—	—	—	—
Impact of transfers between stages	28	(30)	2	—	(2)	—	—	(2)
					—	(2)	—	(2)
Other changes in credit quality					(8)	(14)	1	(21)
Additions and repayments	4,027	(290)	(11)	3,726	(11)	(2)	—	(13)
Credit to the income statement					(19)	(18)	1	(36)
Advances written off			(1)	(1)			(1)	(1)
At 31 December 2021	21,627	38	29	21,694	7	2	1	10
Allowance for impairment losses	(7)	(2)	(1)	(10)				
Net carrying amount	21,620	36	28	21,684				
Debt securities								
At 1 January 2021	257	—	—	257	—	—	—	—
Exchange and other adjustments[1]	1	—	—	1	—	—	—	—
Additions and repayments	(29)	—	—	(29)	—	—	—	—
At 31 December 2021	229	—	—	229	—	—	—	—
Allowance for impairment losses	—	—	—	—				
Net carrying amount	229	—	—	229				
Due from fellow Lloyds Banking Group undertakings								
At 31 December 2021	862	—	—	862				
Allowance for impairment losses	—	—	—	—				
Net carrying amount	862	—	—	862				
Total financial assets at amortised cost	25,580	36	28	25,644				

Note 13: Financial assets at amortised cost (continued)

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

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

	Allowance for expected credit losses			
The Bank	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Undrawn balances				
At 1 January 2021	**20**	**13**	**—**	**33**
Exchange and other adjustments[1]	**(1)**	**(1)**	**—**	**(2)**
Transfers to Stage 1	**4**	**(4)**	**—**	**—**
Transfers to Stage 2	**—**	**—**	**—**	**—**
Transfers to Stage 3	**—**	**—**	**—**	**—**
Impact of transfers between stages	**(4)**	**—**	**—**	**(4)**
	—	**(4)**	**—**	**(4)**
Other changes in credit quality	**(13)**	**(8)**	**—**	**(21)**
Credit to the income statement	**(13)**	**(12)**	**—**	**(25)**
At 31 December 2021	**6**	**—**	**—**	**6**

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

The Bank's total impairment allowances were as follows:

	Allowance for expected credit losses			
The Bank	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
In respect of:				
Loans and advances to banks and reverse repurchase agreements	**1**	**—**	**—**	**1**
Loans and advances to customers and reverse repurchase agreements	**7**	**2**	**1**	**10**
Financial assets at amortised cost	**8**	**2**	**1**	**11**
Provisions in relation to loan commitments and financial guarantees	**6**	**—**	**—**	**6**
Total	**14**	**2**	**1**	**17**

Note 13: Financial assets at amortised cost (continued)

Year ended 31 December 2020

The Bank	Gross carrying amount Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loans and advances to banks and reverse repurchase agreements								
At 1 January 2020	4,793	—	—	4,793	1	—	—	1
Exchange and other adjustments[1]	75	—	—	75	—	—	—	—
Additions and repayments	365	—	—	365	—	—	—	—
Other changes in credit quality					1	—	—	1
Charge to the income statement					1	—	—	1
At 31 December 2020	5,233	—	—	5,233	2	—	—	2
Allowance for impairment losses	(2)	—	—	(2)				
Net carrying amount	5,231	—	—	5,231				
Loans and advances to customers and reverse repurchase agreements								
At 1 January 2020	19,759	19	293	20,071	6	2	77	85
Exchange and other adjustments[1]	300	(75)	(222)	3	(1)	(1)	(9)	(11)
Transfers to Stage 1	1	(1)	—	—	2	(2)	—	—
Transfers to Stage 2	(331)	331	—	—	—	—	—	—
Transfers to Stage 3	(2)	(29)	31	—	—	—	—	—
Impact of transfers between stages	(332)	301	31	—	(2)	3	—	1
					—	1	—	1
Other changes in credit quality					7	16	(7)	16
Additions and repayments	(1,894)	119	(3)	(1,778)	13	2	1	16
Charge (credit) to the income statement					20	19	(6)	33
Advances written off			(60)	(60)			(60)	(60)
At 31 December 2020	17,833	364	39	18,236	25	20	2	47
Allowance for impairment losses	(25)	(20)	(2)	(47)				
Net carrying amount	17,808	344	37	18,189				
Debt securities								
At 1 January 2020	112	—	—	112	—	—	—	—
Exchange and other adjustments[1]	(4)	—	—	(4)	—	—	—	—
Additions and repayments	149	—	—	149	—	—	—	—
At 31 December 2020	257	—	—	257	—	—	—	—
Allowance for impairment losses	—	—	—	—				
Net carrying amount	257	—	—	257				
Due from fellow Lloyds Banking Group undertakings								
At 31 December 2020	1,218	—	—	1,218				
Allowance for impairment losses	—	—	—	—				
Net carrying amount	1,218	—	—	1,218				
Total financial assets at amortised cost	24,514	344	37	24,895				

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

Note 13: Financial assets at amortised cost (continued)

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

	Allowance for expected credit losses			
	Stage 1	Stage 2	Stage 3	Total
The Bank	£m	£m	£m	£m
Undrawn balances				
At 1 January 2020	4	—	—	4
Exchange and other adjustments[1]	(6)	(1)	—	(7)
Transfers to Stage 1	—	—	—	—
Transfers to Stage 2	(1)	1	—	—
Transfers to Stage 3	—	—	—	—
Impact of transfers between stages	—	12	—	12
	(1)	13	—	12
Other changes in credit quality	23	1	—	24
Charge to the income statement	22	14	—	36
At 31 December 2020	20	13	—	33

1. Exchange and other adjustments includes the impact of movements in exchange rates, discount unwind and derecognising assets as a result of modifications.

The Bank's total impairment allowances were as follows:

	Allowance for expected credit losses			
	Stage 1	Stage 2	Stage 3	Total
The Bank	£m	£m	£m	£m
In respect of:				
Loans and advances to banks and reverse repurchase agreements	2	—	—	2
Loans and advances to customers and reverse repurchase agreements	25	20	2	47
Financial assets at amortised cost	27	20	2	49
Provisions in relation to loan commitments and financial guarantees	20	13	—	33
Total	47	33	2	82

The movement tables are compiled by comparing the position at 31 December to that at the beginning of the year. Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December.

Additions and repayments comprise new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to Stage 3 before acquiring a full allowance and subsequent write-off.

At 31 December 2021 £1,443 million (2020: £2,065 million) of loans and advances to banks and reverse repurchase agreements of the Group and £1,443 million (2020: £2,065 million) of the Bank had a contractual residual maturity of greater than one year.

At 31 December 2021 £8,048 million (2020: £7,976 million) of loans and advances to customers and reverse repurchase agreements of the Group and £7,831 million (2020: £7,830 million) of the Bank had a contractual residual maturity of greater than one year.

At 31 December 2021 £126 million (2020: £147 million) of debt securities of the Group and £126 million (2020: £147 million) of the Bank had a contractual residual maturity of greater than one year.

For amounts included above which are subject to reverse repurchase agreements see note 34.

Note 14: Finance lease receivables

Finance lease receivables are classified as loans and advances to customers and accounted for at amortised cost. The balance is analysed as follows:

	The Group	
	2021	2020
	£m	£m
Not later than 1 year	**7**	6
Later than 1 year and not later than 2 years	**7**	7
Later than 2 years and not later than 3 years	**8**	7
Later than 3 years and not later than 4 years	**8**	7
Later than 4 years and not later than 5 years	**9**	8
Later than 5 years	**187**	187
Gross investment in finance leases	**226**	222
Unearned future finance income on finance leases	**(86)**	(86)
Rentals received in advance	**(2)**	(2)
Net investment in finance leases	**138**	134

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

	The Group	
	2021	2020
	£m	£m
Not later than 1 year	**(2)**	(2)
Later than 1 year and not later than 2 years	**1**	1
Later than 2 years and not later than 3 years	**2**	1
Later than 3 years and not later than 4 years	**2**	2
Later than 4 years and not later than 5 years	**3**	2
Later than 5 years	**132**	130
Net investment in finance leases	**138**	134

Equipment leased to customers under finance leases primarily relates to structured financing transactions in connection with infrastructure assets. There was £nil (2020: £nil) allowance for uncollectable finance lease receivables included in the allowance for impairment losses.

Note 15: Financial assets at fair value through other comprehensive income

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Debt securities:				
Asset-backed securities:				
Other asset-backed securities	**15**	113	**15**	113
	15	113	**15**	113
Treasury and other bills	**85**	36	**85**	36
Total financial assets at fair value through other comprehensive income	**100**	149	**100**	149

At 31 December 2021 £14 million (2020: £115 million) of financial assets at fair value through other comprehensive income of the Group and the Bank had a contractual residual maturity of greater than one year.

All assets were assessed at Stage 1 at 31 December 2020 and 2021.

Note 16: Property, plant and equipment

	The Group				The Bank			
	Premises	Equipment	Right-of-use asset[1]	Total	Premises	Equipment	Right-of-use asset[1]	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cost or valuation:								
At 1 January 2020	10	33	72	115	—	31	56	87
Exchange and other adjustments	—	—	(2)	(2)	—	—	(2)	(2)
Additions	3	2	19	24	3	1	16	20
Disposals	(4)	(5)	(1)	(10)	—	(3)	—	(3)
At 31 December 2020	9	30	88	127	3	29	70	102
Exchange and other adjustments	—	—	—	—	—	—	1	1
Additions	6	1	2	9	2	1	—	3
Disposals	(1)	(1)	(6)	(8)	—	(1)	(1)	(2)
At 31 December 2021	**14**	**30**	**84**	**128**	**5**	**29**	**70**	**104**
Accumulated depreciation and impairment:								
At 1 January 2020	7	24	12	43	—	23	9	32
Exchange and other adjustments	—	1	(1)	—	—	—	(1)	(1)
Depreciation charge for the year (note 7)	—	3	13	16	—	3	10	13
Disposals	(4)	(5)	(1)	(10)	—	(3)	—	(3)
At 31 December 2020	3	23	23	49	—	23	18	41
Exchange and other adjustments	—	—	—	—	—	—	—	—
Depreciation charge for the year (note 7)	1	2	12	15	—	2	8	10
Disposals	(1)	(1)	(1)	(3)	—	—	—	—
At 31 December 2021	**3**	**24**	**34**	**61**	**—**	**25**	**26**	**51**
Balance sheet amount at 31 December 2021	**11**	**6**	**50**	**67**	**5**	**4**	**44**	**53**
Balance sheet amount at 31 December 2020	6	7	65	78	3	6	52	61

1. Relates to premises

The total cash outflow for Right-of-use assets in the year ended 31 December 2021 was £12million. The amount recognised within interest expense in respect of lease liabilities is disclosed in note 4.

Note 17: Investment in subsidiary undertakings of the Bank

	2021	2020
	£m	£m
At 1 January	**223**	295
Additions and capital injections	**—**	—
Disposals	**—**	—
Impairment	**(20)**	(72)
At 31 December	**203**	223

Details of the subsidiaries and related undertakings are given on page 111 and are incorporated by reference.

During the year ended 31 December 2021, following a review of their financial position and anticipated future activities, the Bank wrote down the carrying value of its investment in certain subsidiaries to their recoverable amount. For those subsidiaries that generate net income, the recoverable value was based on value in use; for the others, recoverable value was based on fair value less costs of disposal.

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

Note 18: Other assets

	The Group		The Bank	
	2021	2020	2021	2020
	£m	£m	£m	£m
Settlement balances	**279**	997	**276**	997
Prepayments and accrued income	**27**	22	**22**	17
Other assets	**18**	6	**19**	5
Total other assets	**324**	1,025	**317**	1,019

Note 19: Financial liabilities at fair value through profit or loss

	The Group and the Bank	
	2021	2020
	£m	£m
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	**14,962**	14,997
Other deposits	**—**	3
Short positions in securities	**1,620**	815
Total financial liabilities at fair value through profit or loss	**16,582**	15,815

At 31 December 2021, the Group and the Bank had £1,602 million (2020: £823 million) of trading liabilities at fair value through profit or loss with a contractual residual maturity of greater than one year.

For the fair value of collateral pledged in respect of repurchase agreements see note 34.

Note 20: Debt securities in issue

	The Group and the Bank	
	2021	2020
	£m	£m
Medium-term notes issued	**4,181**	4,891
Certificates of deposit issued	**4,164**	4,405
Commercial paper	**5,129**	2,610
Amounts due to fellow Group undertakings	**3,170**	3,696
Total debt securities in issue	**16,644**	15,602

At 31 December 2021 £6,320 million (2020: £7,107 million) of debt securities in issue of the Group and the Bank had a contractual residual maturity of greater than one year.

Note 21: Other liabilities

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Settlement balances	**310**	876	**310**	875
Lease liabilities	**58**	71	**48**	55
Other creditors and accruals[1]	**93**	61	**86**	55
Total other liabilities	**461**	1,008	**444**	985

1. Restated, see note 1.

The maturity analysis of the lease liabilities on an undiscounted basis is set out in the liquidity risk section of note 34.

Note 22: Deferred tax

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

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Statutory position				
Deferred tax assets	**37**	19	**40**	18
Deferred tax liabilities	**—**	(38)	**—**	(35)
Net deferred tax asset (liability) at 31 December	**37**	(19)	**40**	(17)
Tax disclosure				
Deferred tax assets	**56**	19	**40**	18
Deferred tax liabilities	**(19)**	(38)		(35)
Net deferred tax asset (liability) at 31 December	**37**	(19)	**40**	(17)

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated balance sheet and takes into account the ability of the Group and the Bank to net assets and liabilities where there is a legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the tables below which splits the deferred tax assets and liabilities by type, before such netting.

Finance Act 2021, which was substantively enacted on 24 May 2021, increases the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023. The impact of this rate change is an increase in the Group's net deferred tax asset as at 31 December 2021 of £4 million, comprising a £1 million charge included in the income statement and a £3m credit included in equity. The tax credit in 2020 included an uplift in deferred tax assets following the announcement by the UK Government that it would maintain the corporation tax rate at 19 per cent.

Note 22: Deferred tax (continued)

On 27 October 2021, the UK Government announced its intention to decrease the rate of banking surcharge from 8 per cent to 3 per cent with effect from 1 April 2023. This change was substantively enacted on 2 February 2022 and its impact on deferred tax is therefore not included in these financial statements. Had this change in banking surcharge rate been substantively enacted at 31 December 2021, the impact would have been to recognise a further £2 million charge within other comprehensive income, decreasing the Group's deferred tax asset by £2 million.

Deferred tax in relation to the United States of America branch of the Bank has been recognised at a rate of 30%, being the estimated combined Federal, State and Local taxes rate for the period. This is an increase in rate to better reflect the allocation of the different State and Local taxes expected in the final branch tax return and results in a £2 million credit to the income statement and an increase in the Group's deferred tax asset of £2 million.

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

The Group Deferred tax assets	Tax losses £m	IFRS 9 impairments deductible in the future £m	Cash flow hedges £m	Other internal derivatives £m	Fair value through other comprehensive income £m	Other temporary differences £m	Total £m
At 1 January 2020	4	—	—	—	—	2	6
(Charge) credit to the income statement	(2)	10	—	—	—	6	14
(Charge) to other comprehensive income	—	—	—	—	—	(1)	(1)
At 31 December 2020	2	10	—	—	—	7	19
(Charge) credit to the income statement	1	(7)	—	13	—	8	15
Credit to other comprehensive income	—	—	21	—	1	—	22
Exchange and other adjustments	—	—	—	—	—	—	—
At 31 December 2021	**3**	**3**	**21**	**13**	**1**	**15**	**56**

The Group Deferred tax liabilities	Accelerated capital allowances £m	Cash flow hedges £m	Other internal derivatives £m	Fair value through other comprehensive income £m	Other temporary differences £m	Total £m
At 1 January 2020	(11)	(18)	7	3	1	(18)
(Charge) credit to other comprehensive income	(3)	(21)	4	1	(1)	(20)
At 31 December 2020	(14)	(39)	11	4	—	(38)
(Charge) to the income statement	(5)	—	(11)	—	—	(16)
(Charge) credit to other comprehensive income	—	39	—	(4)	—	35
Exchange and other adjustments	—	—	—	—	—	—
At 31 December 2021	**(19)**	**—**	**—**	**—**	**—**	**(19)**

Note 22: Deferred tax (continued)

The Bank Deferred tax assets	Tax losses £m	IFRS 9 Impairments deductible in the future £m	Cash flow hedges £m	Fair value through other comprehensive income £m	Other temporary differences £m	Total £m
At 1 January 2020	2	—		—	—	2
(Charge) credit to the income statement	(1)	10	—	—	8	17
(Charge) to other comprehensive income	—	—	—	—	(1)	(1)
At 31 December 2020	1	10	—	—	7	18
(Charge) credit to the income statement	—	(7)		—	7	—
Credit to other comprehensive income	—	—	21	1	—	22
Exchange and other adjustments			—	—	—	—
At 31 December 2021	1	3	21	1	14	40

The Bank Deferred tax liabilities	Cash flow hedges £m	Fair value through other comprehensive income £m	Other temporary differences £m	Total £m
At 1 January 2020	(18)	3	(1)	(16)
(Charge) credit to other comprehensive income	(21)	1	1	(19)
At 31 December 2020	(39)	4	—	(35)
(Charge) credit to the income statement	—	—	—	—
(Charge) credit to other comprehensive income	39	(4)	—	35
Exchange and other adjustments	—	—	—	—
At 31 December 2021	—	—	—	—

Deferred tax not recognised
Deferred tax assets of approximately £3 million (2020: £4 million) for the Group and £2 million (2020: £4 million) for the Bank have not been recognised in respect of overseas tax losses and other temporary differences where it is currently not probable that there will be future profits against which they can be used.

Note 23: Other provisions

	The Group				The Bank			
	Provisions for financial commitments and guarantees £m	Regulatory and legal provisions £m	Other £m	Total £m	Provisions for financial commitments and guarantees £m	Regulatory and legal provisions £m	Other £m	Total £m
At 1 January 2021	33	1	3	37	33	1	1	35
Exchange and other adjustments	(2)	—	—	(2)	(2)	—	—	(2)
Provisions applied	—	—	(1)	(1)	—	—	—	—
(Release) charge for the year	(25)	1	3	(21)	(25)	1	1	(23)
At 31 December 2021	6	2	5	13	6	2	2	10

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

Note 24: Subordinated liabilities

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

	The Group and the Bank	
	2021	2020
Dated subordinated liabilities	**£m**	£m
At 1 January	**686**	698
Issued during the year	**—**	—
Repurchases and redemptions during the year	**—**	—
Foreign exchange movements	**(2)**	(11)
Other movements (all non-cash)	**—**	(1)
At 31 December	**684**	686

Note 25: Share capital

(1) Issued and fully paid ordinary shares

	The Group and the Bank			
	2021	2020	**2021**	2020
	Number of shares	Number of shares	**£m**	£m
Ordinary shares of £1 each				
At 1 January and 31 December	**120,050,000**	120,050,000	**120**	120

(2) Share capital and control
There are no limitations on voting rights or restrictions on the transfer of shares in the Bank 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 2021, are entitled to receive the Bank'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 Bank's articles of association) and on a winding up may share in the assets of the Bank.

Note 26: Other reserves

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**(2)**	(10)	**(2)**	(10)
Cash flow hedging reserve	**(48)**	105	**(48)**	105
Foreign currency translation reserve	**(14)**	(14)	**(12)**	(12)
At 31 December	**(64)**	81	**(62)**	83

The revaluation reserves in respect of debt securities held at fair value through other comprehensive income represent the cumulative after-tax unrealised change in the fair value of financial assets so classified since initial recognition.

The cash flow hedging reserve represents the cumulative after-tax gains and losses on effective cash flow hedging instruments that will be reclassified to the income statement in the periods in which the hedged item affects profit or loss.

The foreign currency translation reserve represents the cumulative after-tax gains and losses on the translation of foreign operations and exchange differences arising on financial instruments designated as hedges of the Group's net investment in foreign operations.

Movements in other reserves were as follows:

	The Group		The Bank	
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**2021** **£m**	2020 £m	**2021** **£m**	2020 £m
At 1 January	**(10)**	(9)	**(10)**	(9)
Change in fair value	**5**	(2)	**5**	(2)
Deferred tax	**(1)**	1	**(1)**	1
	4	(1)	**4**	(1)
Income statement transfers in respect of disposals	**5**	—	**5**	—
Deferred tax	**(1)**	—	**(1)**	—
	4	—	**4**	—
At 31 December	**(2)**	(10)	**(2)**	(10)

Note 26: Other reserves (continued)

	The Group		The Bank	
	2021	2020	**2021**	2020
Cash flow hedging reserve	**£m**	£m	**£m**	£m
At 1 January	**105**	56	**105**	56
Change in fair value of hedging derivatives	**(169)**	93	**(169)**	93
Deferred tax	**48**	(27)	**48**	(27)
	(121)	66	**(121)**	66
Net income statement transfers	**(44)**	(23)	**(44)**	(23)
Deferred tax	**12**	6	**12**	6
	(32)	(17)	**(32)**	(17)
At 31 December	**(48)**	105	**(48)**	105

	The Group		The Bank	
	2021	2020	**2021**	2020
Foreign currency translation reserve	**£m**	£m	**£m**	£m
At 1 January	**(14)**	(15)	**(12)**	(16)
Currency translation differences arising in the year	**—**	1	**—**	4
At 31 December	**(14)**	(14)	**(12)**	(12)

Note 27: Retained profits

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
At 1 January	**2,646**	3,342	**2,711**	3,442
Profit / (loss) attributable to ordinary shareholders[1]	**205**	4	**214**	(31)
Dividends paid (note 29)	**(200)**	(700)	**(200)**	(700)
At 31 December	**2,651**	2,646	**2,725**	2,711

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

Note 28: Other equity instruments

	The Group and the Bank	
	2021	2020
	£m	£m
At 1 January	**782**	782
Profit for the year attributable to other equity holders	**33**	40
Distributions on other equity instruments	**(33)**	(40)
At 31 December	**782**	782

The Bank has in issue £782 million of Dollar and Euro Additional Tier 1 (AT1) securities to Lloyds Banking Group plc. The AT1 securities are floating rate 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 the Bank of unsubordinated creditors on a winding-up.
- The fixed rate reset 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 fixed rate reset AT1 securities will bear interest at rates fixed periodically in advance. The floating rate AT1 securities will be reset quarterly both prior to and following the first call date.
- Interest on the securities will be due and payable only at the sole discretion of the Bank and the Bank 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 the Bank, 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 the Bank, 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 the Bank fall below 7.0 per cent.

Note 29: Dividends on ordinary shares

Dividends paid during the year were as follows:

	2021 £m	2020 £m
Interim dividends	**200**	700

The directors have proposed an interim dividend of £220 million to be paid in April 2022.

Note 30: Related party transactions

Key management personnel
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity, the Group's key management personnel are the members of the Lloyds Bank Corporate Markets plc board.

The table below represents key management emoluments:

	2021 £000	2020 £000
Compensation		
Salaries and other short-term benefits	**1,987**	2,299
Post-employment benefits	**63**	43
Total compensation	**2,050**	2,342

The aggregate of the emoluments of the directors was £1,885,000 (2020: £2,011,000). The total for the highest paid director was £724,000 (2020: £896,000)

The amounts disclosed above relate wholly to directors of the Group.

Balances and transactions with fellow Lloyds Banking Group undertakings
Balances and transactions between members of the Lloyds Bank Corporate Markets Group
In accordance with IFRS 10 *Consolidated Financial Statements*, transactions and balances between the Bank 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 Bank, as a result of its position as parent of a banking group, has a large number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Bank as follows:

	2021 £m	2020 £m
Assets, included within:		
Derivative financial instruments	**52**	61
Financial assets at amortised cost: due from fellow Lloyds Bank Corporate Markets Group undertakings	**341**	293
	393	354
Liabilities, included within:		
Due to fellow Lloyds Bank Corporate Markets Group undertakings	**481**	383
	481	383

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 2021 the Bank earned interest income on the above asset balances of £2 million (2020: £3 million) and incurred interest expense on the above liability balances of £nil (2020: £1 million).

Note 30: Related party transactions (continued)

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

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Assets, included within:				
Financial assets at fair value through profit or loss	**12**	27	**12**	27
Derivative financial instruments	**2,094**	2,911	**2,094**	2,911
Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings	**557**	1,118	**521**	925
	2,663	4,056	**2,627**	3,863
Liabilities, included within:				
Due to fellow Lloyds Banking Group undertakings	**3,442**	3,283	**3,439**	3,276
Derivative financial instruments	**2,579**	3,788	**2,579**	3,788
Debt securities in issue	**3,170**	3,696	**3,170**	3,696
Subordinated liabilities	**684**	686	**684**	686
	9,875	11,453	**9,872**	11,446
Other equity instruments:				
Additional tier 1 instruments	**782**	782	**782**	782
	782	782	**782**	782

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 2021 the Group earned £2 million and the Bank earned £2 million interest income on the above asset balances (2020: Group £9 million, Bank £9 million); the Group incurred £104 million and the Bank incurred £104 million interest expense on the above liability balances (2020: Group £143 million, Bank £143 million).

The Group earned £96 million and the Bank earned £94 million of fee and commission income (2020: Group £87 million, Bank £84 million); the Group incurred £nil and the Bank incurred £nil of fee and commission expense (2020: Group £nil, Bank £nil), both in respect of transactions with Lloyds Bank plc.

Management charges payable to Lloyds Bank plc of £(155) million (2020: £186 million) have been incurred in the year see note 7 for further detail.

During 2021, the Bank sold a portfolio of facilities (£92 million of assets and £521 million of commitments) to Lloyds Bank plc, no significant gain or loss arose.

Note 31: Contingent liabilities, commitments and guarantees

Legal actions and regulatory matters
During the ordinary course of business the Group is subject to complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, which could relate to a number of issues, including financial, environmental or other regulatory matters, both in the UK and overseas. Where material, such matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established based on management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed to assess properly the merits of the case, and no provisions are held in relation to such matters. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. However, the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations of cash flows.

	The Group and the Bank	
	2021	2020
	£m	£m
Contingent liabilities		
Acceptances and endorsements	**170**	57
Other:		
Other items serving as direct credit substitutes	**77**	96
Performance bonds, including letters of credit, and other transaction-related contingencies	**158**	34
	235	130
Total contingent liabilities	**405**	187

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

Note 31: Contingent liabilities, commitments and guarantees (continued)

	The Group and the Bank	
	2021	2020
	£m	£m
Commitments and guarantees		
Forward asset purchases and forward deposits placed	**—**	3
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**50**	52
Other commitments and guarantees	**8,831**	7,466
	8,881	7,518
1 year or over original maturity	**6,310**	7,014
Total commitments and guarantees	**15,191**	14,535

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £15,124 million (2020: £14,416 million) for the Group and the Bank were irrevocable.

Capital commitments
There were no contracted capital commitments at the balance sheet date.

Note 32: 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 tables analyse the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

Note 32: Financial instruments (continued)

The Group	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	At fair value through other comprehensive income £m	Held at amortised cost £m	Total £m
At 31 December 2021						
Financial assets						
Cash and balances at central banks	**—**	**—**	**—**	**—**	**22,140**	**22,140**
Financial assets at fair value through profit or loss	**—**	**21,773**	**636**	**—**	**—**	**22,409**
Derivative financial instruments	**7**	**17,983**	**—**	**—**	**—**	**17,990**
Loans and advances to banks and reverse repurchase agreements	**—**	**—**	**—**	**—**	**2,890**	**2,890**
Loans and advances to customers and reverse repurchase agreements	**—**	**—**	**—**	**—**	**21,940**	**21,940**
Debt securities	**—**	**—**	**—**	**—**	**229**	**229**
Due from fellow Lloyds Banking Group undertakings	**—**	**—**	**—**	**—**	**557**	**557**
Financial assets at amortised cost	**—**	**—**	**—**	**—**	**25,616**	**25,616**
Financial assets at fair value through other comprehensive income	**—**	**—**	**—**	**100**	**—**	**100**
Total financial assets	**7**	**39,756**	**636**	**100**	**47,756**	**88,255**
Financial liabilities						
Deposits from banks	**—**	**—**	**—**	**—**	**3,821**	**3,821**
Customer deposits and repurchase agreements	**—**	**—**	**—**	**—**	**27,986**	**27,986**
Due to fellow Lloyds Banking Group undertakings	**—**	**—**	**—**	**—**	**3,442**	**3,442**
Financial liabilities at fair value through profit or loss	**—**	**16,582**	**—**	**—**	**—**	**16,582**
Derivative financial instruments	**3**	**15,569**	**—**	**—**	**—**	**15,572**
Debt securities in issue	**—**	**—**	**—**	**—**	**16,644**	**16,644**
Other	**—**	**—**	**—**	**—**	**58**	**58**
Subordinated liabilities	**—**	**—**	**—**	**—**	**684**	**684**
Total financial liabilities	**3**	**32,151**	**—**	**—**	**52,635**	**84,789**
At 31 December 2020						
Financial assets						
Cash and balances at central banks	—	—	—	—	23,369	23,369
Financial assets at fair value through profit or loss	—	20,262	664	—	—	20,926
Derivative financial instruments	6	21,751	—	—	—	21,757
Loans and advances to banks and reverse repurchase agreements	—	—	—	—	5,260	5,260
Loans and advances to customers and reverse repurchase agreements	—	—	—	—	18,452	18,452
Debt securities	—	—	—	—	257	257
Due from fellow Lloyds Banking Group undertakings	—	—	—	—	1,118	1,118
Financial assets at amortised cost	—	—	—	—	25,087	25,087
Financial assets at fair value through other comprehensive income	—	—	—	149	—	149
Total financial assets	6	42,013	664	149	48,456	91,288
Financial liabilities						
Deposits from banks	—	—	—	—	5,601	5,601
Customer deposits and repurchase agreements	—	—	—	—	25,497	25,497
Due to fellow Lloyds Banking Group undertakings	—	—	—	—	3,283	3,283
Financial liabilities at fair value through profit or loss	—	15,815	—	—	—	15,815
Derivative financial instruments	3	21,230	—	—	—	21,233
Debt securities in issue	—	—	—	—	15,602	15,602
Other	—	—	—	—	71	71
Subordinated liabilities	—	—	—	—	686	686
Total financial liabilities	3	37,045	—	—	50,740	87,788

Note 32: Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	At fair value through other comprehensive income £m	Held at amortised cost £m	Total £m
At 31 December 2021						
Financial assets						
Cash and balances at central banks	—	—	—	—	22,140	22,140
Financial assets at fair value through profit or loss	—	21,773	495	—	—	22,268
Derivative financial instruments	7	18,035	—	—	—	18,042
Loans and advances to banks and reverse repurchase agreements	—	—	—	—	2,869	2,869
Loans and advances to customers and reverse repurchase agreements	—	—	—	—	21,684	21,684
Debt securities	—	—	—	—	229	229
Due from fellow Lloyds Banking Group undertakings	—	—	—	—	862	862
Financial assets at amortised cost	—	—	—	—	25,644	25,644
Financial assets at fair value through other comprehensive income	—	—	—	100	—	100
Total financial assets	7	39,808	495	100	47,784	88,194
Financial liabilities						
Deposits from banks	—	—	—	—	3,821	3,821
Customer deposits and repurchase agreements	—	—	—	—	27,572	27,572
Due to fellow Lloyds Banking Group undertakings	—	—	—	—	3,920	3,920
Financial liabilities at fair value through profit or loss	—	16,582	—	—	—	16,582
Derivative financial instruments	3	15,568	—	—	—	15,571
Debt securities in issue	—	—	—	—	16,644	16,644
Other	—	—	—	—	48	48
Subordinated liabilities	—	—	—	—	684	684
Total financial liabilities	3	32,150	—	—	52,689	84,842
At 31 December 2020						
Financial assets						
Cash and balances at central banks	—	—	—	—	23,369	23,369
Financial assets at fair value through profit or loss	—	20,262	579	—	—	20,841
Derivative financial instruments	6	21,812	—	—	—	21,818
Loans and advances to banks and reverse repurchase agreements	—	—	—	—	5,231	5,231
Loans and advances to customers and reverse repurchase agreements	—	—	—	—	18,189	18,189
Debt securities	—	—	—	—	257	257
Due from fellow Lloyds Banking Group undertakings	—	—	—	—	1,218	1,218
Financial assets at amortised cost	—	—	—	—	24,895	24,895
Financial assets at fair value through other comprehensive income	—	—	—	149	—	149
Total financial assets	6	42,074	579	149	48,264	91,072
Financial liabilities						
Deposits from banks	—	—	—	—	5,601	5,601
Customer deposits and repurchase agreements	—	—	—	—	25,061	25,061
Due to fellow Lloyds Banking Group undertakings	—	—	—	—	3,659	3,659
Financial liabilities at fair value through profit or loss	—	15,815	—	—	—	15,815
Derivative financial instruments	3	21,230	—	—	—	21,233
Debt securities in issue	—	—	—	—	15,602	15,602
Other	—	—	—	—	55	55
Subordinated liabilities	—	—	—	—	686	686
Total financial liabilities	3	37,045	—	—	50,664	87,712

Note 32: Financial instruments (continued)

(2) Fair value measurement

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

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

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

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 premises and equipment; and shareholders' equity. These items are material and accordingly the Group believes that any fair value information presented would not represent the underlying value of the Group.

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

Model validation covers both qualitative and quantitative elements relating to new models. In respect of new products, a product implementation review is conducted pre- and post-trading. Pre-trade testing ensures that the new model is integrated into the Group's systems and that the profit and loss and risk reporting are consistent throughout the trade 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), funding valuation adjustment (FVA) and other valuation adjustments.

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

Level 1
Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise 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 any 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. For information on key estimates surrounding financial instruments, see note 3.

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

Note 32: Financial instruments (continued)

(3) Financial assets and liabilities carried at fair value

(A) Financial assets, excluding derivatives

Valuation hierarchy

At 31 December 2021, the Group's financial assets carried at fair value, excluding derivatives, totalled £22,509 million (2020: £21,075 million); and for the Bank totalled £22,368 million (2020: £20,990 million). The table below analyses these financial assets by balance sheet classification, asset type and valuation methodology (level 1, 2 or 3, as described on page 78). 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 2021				
Financial assets at fair value through profit or loss				
Loans and advances to banks and reverse repurchase agreements	**—**	**486**	**—**	**486**
Loans and advances to customers and reverse repurchase agreements	**—**	**14,741**	**2**	**14,743**
Debt securities:				
Government securities	**6,580**	**—**	**—**	**6,580**
Bank and building society certificates of deposit	**—**	**122**	**—**	**122**
Asset-backed securities:				
Mortgage-backed securities	**—**	**12**	**—**	**12**
Other asset-backed securities	**—**	**3**	**—**	**3**
Corporate and other debt securities	**—**	**256**	**188**	**444**
	6,580	**393**	**188**	**7,161**
Treasury and other bills	**19**	**—**	**—**	**19**
Equity shares	**—**	**—**	**—**	**—**
Total financial assets at fair value through profit or loss	**6,599**	**15,620**	**190**	**22,409**
Financial assets at fair value through other comprehensive income				
Debt securities:				
Asset-backed securities:				
Other asset-backed securities	**—**	**—**	**15**	**15**
	—	**—**	**15**	**15**
Treasury and other bills	**85**	**—**	**—**	**85**
Total financial assets at fair value through other comprehensive income	**85**	**—**	**15**	**100**
Total financial assets carried at fair value, excluding derivatives	**6,684**	**15,620**	**205**	**22,509**
At 31 December 2020				
Financial assets at fair value through profit or loss				
Loans and advances to banks and reverse repurchase agreements	—	229	—	229
Loans and advances to customers and reverse repurchase agreements	—	12,775	344	13,119
Debt securities:				
Government securities	6,983	—	—	6,983
Bank and building society certificates of deposit	—	66	—	66
Asset-backed securities:				
Mortgage-backed securities	—	7	—	7
Other asset-backed securities	—	4	—	4
Corporate and other debt securities	—	273	223	496
	6,983	350	223	7,556
Treasury and other bills	19	—	—	19
Equity shares	—	—	3	3
Total financial assets at fair value through profit or loss	7,002	13,354	570	20,926
Financial assets at fair value through other comprehensive income				
Debt securities:				
Asset-backed securities:				
Other asset-backed securities	—	—	113	113
	—	—	113	113
Treasury and other bills	36	—	—	36
Total financial assets at fair value through other comprehensive income	36	—	113	149
Total financial assets carried at fair value, excluding derivatives	7,038	13,354	683	21,075

Note 32: Financial instruments (continued)

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2021				
Financial assets at fair value through profit or loss				
Loans and advances to banks and reverse repurchase agreements	**—**	**486**	**—**	**486**
Loans and advances to customers and reverse repurchase agreements	**—**	**14,741**	**2**	**14,743**
Debt securities:				
Government securities	**6,580**	**—**	**—**	**6,580**
Asset-backed securities:				
Mortgage-backed securities	**—**	**12**	**—**	**12**
Other asset-backed securities	**—**	**3**	**—**	**3**
Corporate and other debt securities	**—**	**256**	**188**	**444**
	6,580	**271**	**188**	**7,039**
Treasury and other bills	**—**	**—**	**—**	**—**
Equity shares	**—**	**—**	**—**	**—**
Total financial assets at fair value through profit or loss	**6,580**	**15,498**	**190**	**22,268**
Financial assets at fair value through other comprehensive income				
Debt securities:				
Asset-backed securities:				
Other asset-backed securities	**—**	**—**	**15**	**15**
	—	**—**	**15**	**15**
Treasury and other bills	**85**	**—**	**—**	**85**
Total financial assets at fair value through other comprehensive income	**85**	**—**	**15**	**100**
Total financial assets carried at fair value, excluding derivatives	**6,665**	**15,498**	**205**	**22,368**
At 31 December 2020				
Financial assets at fair value through profit or loss				
Loans and advances to banks and reverse repurchase agreements	—	229	—	229
Loans and advances to customers and reverse repurchase agreements	—	12,775	344	13,119
Debt securities:				
Government securities	6,983	—	—	6,983
Asset-backed securities:				
Mortgage-backed securities	—	7	—	7
Other asset-backed securities	—	4	—	4
Corporate and other debt securities	—	273	223	496
	6,983	284	223	7,490
Treasury and other bills	—	—	—	—
Equity shares	—	—	3	3
Total financial assets at fair value through profit or loss	6,983	13,288	570	20,841
Financial assets at fair value through other comprehensive income				
Debt securities:				
Asset-backed securities:				
Other asset-backed securities	—	—	113	113
	—	—	113	113
Treasury and other bills	36	—	—	36
Total financial assets at fair value through other comprehensive income	36	—	113	149
Total financial assets carried at fair value, excluding derivatives	7,019	13,288	683	20,990

Note 32: 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).

	2021			2020		
The Group and the Bank	**Financial assets at fair value through profit or loss £m**	**Financial assets at fair value through other comprehensive income £m**	**Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m**	Financial assets at fair value through profit or loss £m	Financial assets at fair value through other comprehensive income £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m
At 1 January	**570**	**113**	**683**	326	121	447
Exchange and other adjustments	**—**	**(6)**	**(6)**	—	4	4
(Losses) gains recognised in the income statement within other income	**(33)**	**—**	**(33)**	3	—	3
Gains recognised in other comprehensive income within the revaluation reserve in respect of financial assets at fair value through other comprehensive income	**—**	**9**	**9**	—	—	—
Purchases/increases to customer loans	**—**	**—**	**—**	410	—	410
Sales/repayments of customer loans	**(231)**	**(101)**	**(332)**	(169)	(12)	(181)
Transfers into the level 3 portfolio	**—**	**—**	**—**	—	—	—
Transfers out of the level 3 portfolio	**(116)**	**—**	**(116)**	—	—	—
At 31 December	**190**	**15**	**205**	570	113	683
(Losses) gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**(32)**	**—**	**(32)**	—	6	6

Valuation methodology for financial assets, excluding derivatives
Loans and advances to customers and banks
The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security sold under the 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 securities
Unlisted equity is valued using techniques in accordance with the Group's valuation policy and International Private Equity and Venture Capital Guidelines. Equity 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 equity 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.

(B) Financial liabilities, excluding derivatives
Valuation hierarchy
At 31 December 2021, the Group and Bank's financial liabilities carried at fair value, excluding derivatives, comprised its financial liabilities at fair value through profit or loss and totalled £16,582 million (2020: £15,815 million). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 78). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

Note 32: Financial instruments (continued)

The Group and the Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2021				
Financial liabilities at fair value through profit or loss				
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**—**	**14,962**	**—**	**14,962**
Other deposits	**—**	**—**	**—**	**—**
Short positions in securities	**1,569**	**51**	**—**	**1,620**
Total financial liabilities carried at fair value, excluding derivatives	**1,569**	**15,013**	**—**	**16,582**
At 31 December 2020				
Financial liabilities at fair value through profit or loss				
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	—	14,997	—	14,997
Other deposits	—	3	—	3
Short positions in securities	777	38	—	815
Total financial liabilities carried at fair value, excluding derivatives	777	15,038	—	15,815

Movements in level 3 portfolio
There have been no movements in level 3 financial liabilities, excluding derivatives, carried at fair value during the year.

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.

(C) Derivatives
Valuation hierarchy
All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2021, such assets totalled £17,990 million for the Group and £18,042 million for the Bank (2020: £21,757 million for the Group and £21,818 million for the Bank) and liabilities totalled £15,572 million for the Group and £15,571 million for the Bank (2020: £21,233 million for the Group and £21,233 million for the Bank). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 78). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

	2021				2020			
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	**22**	**17,239**	**729**	**17,990**	1	20,808	948	21,757
Derivative liabilities	**13**	**14,633**	**926**	**15,572**	9	19,973	1,251	21,233

	2021				2020			
The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	**22**	**17,291**	**729**	**18,042**	1	20,869	948	21,818
Derivative liabilities	**13**	**14,632**	**926**	**15,571**	9	19,973	1,251	21,233

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

	2021		2020	
The Group and the Bank	**Derivative assets £m**	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	**948**	**(1,251)**	785	(1,070)
Exchange and other adjustments	**(4)**	**4**	15	(17)
(Losses) gains recognised in the income statement within other income	**(227)**	**238**	89	(102)
Purchases (additions)	**128**	**(361)**	61	(6)
(Sales) redemptions	**(116)**	**444**	(85)	75
Transfers into the level 3 portfolio	**—**	**—**	83	(131)
Transfers out of the level 3 portfolio	**—**	**—**	—	—
At 31 December	**729**	**(926)**	948	(1,251)
(Losses) gains recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December	**(248)**	**256**	97	(131)

Note 32: Financial instruments (continued)

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

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

Complex interest rate and foreign exchange products where inputs to the valuation are significant, material and unobservable are classified as level 3.

Certain unobservable inputs used to calculate CVA, FVA, and own credit adjustments, are not significant in determining the classification of the derivative and debt instruments. Consequently, these inputs do not form part of the level 3 sensitivities presented.

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

(i) Uncollateralised derivative valuation adjustments
The following table summarises the movement on this valuation adjustment account for the Group during 2020 and 2021:

	2021 £m	2020 £m
At 1 January	**229**	195
Income statement charge (credit)	**71**	53
Transfers	**—**	(19)
At 31 December	**300**	229

Represented by:

	2021 £m	2020 £m
Credit Valuation Adjustment	**195**	185
Debit Valuation Adjustment	**(24)**	(34)
Funding Valuation Adjustment	**129**	78
	300	229

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

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

The CVA is sensitive to:

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

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

The combination of a one notch deterioration in the credit rating of derivative counterparties and a ten per cent increase in LGD increases the CVA by £46 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (although no such adjustment was required at 31 December 2021).

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 £65 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.

Note 32: Financial instruments (continued)

A one per cent rise in interest rates would lead to a £31 million fall in the overall valuation adjustment to £140 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 £20 million.

(ii) Market liquidity
The Group includes mid to bid-offer valuation adjustments against the expected cost of closing out the net market risk in the Group's trading positions within a time frame that is consistent with historical trading activity and spreads that the trading desks have accessed historically during the ordinary course of business in normal market conditions. At 31 December 2021, the Group's derivative trading business held mid to bid-offer valuation adjustments of £51 million (2020: £56 million).

(iii) Day 1 P&L reserves
The Group defers Day 1 gain/losses when the initial fair value of a financial instrument held at fair value through profit or loss relies on unobservable inputs. At 31 December 2021, the Group's derivative trading business held deferred day 1 P&L valuation adjustment of £9 million (2020: £12 million)

(D) Sensitivity of level 3 valuations

The Group and the Bank			2021			2020		
				Effect of reasonably possible alternative assumptions[2]			Effect of reasonably possible alternative assumptions[2]	
	Valuation techniques	Significant unobservable inputs[1]	Carrying value £m	Favourable changes £m	Unfavourable changes £m	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Financial assets at fair value through profit or loss								
Loans and advances to customers	Comparable pricing	Spread (-/+20bps)	**2**	**—**	**—**	344	4	(4)
Debt securities	Discounted cash flows	Credit spreads (discount factor) and inflation volatility (-/+7bps)	**188**	**13**	**(13)**	223	—	(7)
Equity investments	Discounted cash flows	Credit spreads (discount factor) and inflation volatility	**—**	**—**	**—**	3	10	(3)
			190	**13**	**(13)**	570	14	(14)
Financial assets at fair value through other comprehensive income								
Asset-backed securities	Comparable pricing	Price	**—**	**—**	**—**	96	2	(2)
	Comparable pricing	Spread (-/+0bps)	**15**	**—**	**—**	17	1	(1)
			15	**—**	**—**	113	3	(3)
Derivative financial assets								
Interest rate derivatives	Option pricing model	Inflation volatility (31.0-58.7bps)	**345**	**5**	**(4)**	436	5	(3)
	Option pricing model	Interest rate volatility (12.8-167.9bps)	**384**	**1**	**(1)**	512	2	(1)
			729	**6**	**(5)**	948	7	(4)
Level 3 financial assets carried at fair value			**934**	**19**	**(18)**	1,631	24	(21)
Derivative financial liabilities								
Interest rate derivatives	Option pricing model	Illiquid long dated repo rate (-/ +10.2bps)	**2**	**—**	**—**	2	—	—
	Option pricing model	Inflation volatility (31.0-58.7bps)	**297**	**6**	**(5)**	324	2	(3)
	Option pricing model	Interest rate volatility (12.8-167.9bps)	**627**	**11**	**(11)**	925	1	(2)
			926	**17**	**(16)**	1,251	3	(5)
Level 3 financial liabilities carried at fair value			**926**	**17**	**(16)**	1,251	3	(5)

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.

Note 32: Financial instruments (continued)

Unobservable inputs
Significant unobservable inputs affecting the valuation of debt securities and derivatives are as follows:

- Interest rates and inflation rates are referenced in some derivatives where the payoff that the holder of the derivative receives depends on the behaviour of those underlying references through time
- 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

Reasonably possible alternative assumptions
Valuation techniques applied to many of the Group's level 3 instruments often involve the use of two or more inputs whose relationship is interdependent. The calculation of the effect of reasonably possible alternative assumptions included in the table above reflects such relationships.

Debt securities
Reasonably possible alternative assumptions have been determined in respect of the Group's structured credit investment by flexing credit spreads.

Derivatives
Reasonably possible alternative assumptions have been determined in respect of swaptions in the Group's derivative portfolios which are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities have been flexed within a range.

Note 32: Financial instruments (continued)

(4) Financial assets and liabilities carried at amortised cost

(A) Financial assets

Valuation hierarchy

The table below analyses the fair values of the financial assets of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 78). Financial assets carried at amortised cost are mainly classified as level 3 due to significant unobservable inputs used in the valuation models. Where inputs are observable, debt securities are classified as level 1 or 2.

The Group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2021					
Loans and advances to banks and reverse repurchase agreements	**2,890**	**2,890**	**—**	**536**	**2,354**
Loans and advances to customers and reverse repurchase agreements	**21,940**	**21,996**	**—**	**4,508**	**17,488**
Debt securities	**229**	**229**	**—**	**104**	**125**
Due from fellow Lloyds Banking Group undertakings	**557**	**557**	**—**	**—**	**557**
Reverse repurchase agreements included in above amounts:					
Loans and advances to banks and reverse repurchase agreements	**536**	**536**	**—**	**536**	**—**
Loans and advances to customers and reverse repurchase agreements	**4,508**	**4,508**	**—**	**4,508**	**—**
At 31 December 2020					
Loans and advances to banks and reverse repurchase agreements	5,260	5,260	—	1,660	3,600
Loans and advances to customers and reverse repurchase agreements	18,452	18,524	—	4,196	14,328
Debt securities	257	257	—	257	—
Due from fellow Lloyds Banking Group undertakings	1,118	1,118	—	—	1,118
Reverse repurchase agreements included in above amounts:					
Loans and advances to banks and reverse repurchase agreements	1,660	1,660	—	1,660	—
Loans and advances to customers and reverse repurchase agreements	4,196	4,196	—	4,196	—

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2021					
Loans and advances to banks and reverse repurchase agreements	**2,869**	**2,869**	**—**	**536**	**2,333**
Loans and advances to customers and reverse repurchase agreements	**21,684**	**21,740**	**—**	**4,508**	**17,232**
Debt securities	**229**	**229**	**—**	**104**	**125**
Due from fellow Lloyds Banking Group undertakings	**862**	**862**	**—**	**—**	**862**
Reverse repurchase agreements included in above amounts:					
Loans and advances to banks and reverse repurchase agreements	**536**	**536**	**—**	**536**	**—**
Loans and advances to customers and reverse repurchase agreements	**4,508**	**4,508**	**—**	**4,508**	**—**
At 31 December 2020					
Loans and advances to banks and reverse repurchase agreements	5,231	5,231	—	1,660	3,571
Loans and advances to customers and reverse repurchase agreements	18,189	18,261	—	4,196	14,065
Debt securities	257	257	—	257	—
Due from fellow Lloyds Banking Group undertakings	1,218	1,218	—	—	1,218
Reverse repurchase agreements included in above amounts:					
Loans and advances to banks and reverse repurchase agreements	1,660	1,660	—	1,660	—
Loans and advances to customers and reverse repurchase agreements	4,196	4,196	—	4,196	—

Valuation methodology

Loans and advances to banks

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

Loans and advances to customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. Due to their short-term nature, the carrying value of 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

Note 32: Financial instruments (continued)

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.

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

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

(B) Financial liabilities
Valuation hierarchy
The table below analyses the fair values of the financial liabilities of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 78).

			Valuation hierarchy		
	Carrying value	Fair value	Level 1	Level 2	Level 3
The Group	£m	£m	£m	£m	£m
At 31 December 2021					
Deposits from banks	**3,821**	**3,821**	**—**	**3,821**	**—**
Customer deposits and repurchase agreements	**27,986**	**28,066**	**—**	**28,066**	**—**
Due to fellow Lloyds Banking Group undertakings	**3,442**	**3,442**	**—**	**3,442**	**—**
Debt securities in issue	**16,644**	**16,723**	**—**	**16,723**	**—**
Subordinated liabilities	**684**	**684**	**—**	**684**	**—**
Repurchase agreements included in above amounts:					
Customer deposits and repurchase agreements	**1,019**	**1,019**	**—**	**1,019**	**—**
At 31 December 2020					
Deposits from banks	5,601	5,603	—	5,603	—
Customer deposits and repurchase agreements	25,497	25,596	—	25,596	—
Due to fellow Lloyds Banking Group undertakings	3,283	3,283	—	3,283	—
Debt securities in issue	15,602	15,849	—	15,849	—
Subordinated liabilities	686	686	—	686	—
Repurchase agreements included in above amounts:					
Customer deposits and repurchase agreements	—	—	—	—	—

			Valuation hierarchy		
	Carrying value	Fair value	Level 1	Level 2	Level 3
The Bank	£m	£m	£m	£m	£m
At 31 December 2021					
Deposits from banks	**3,821**	**3,821**	**—**	**3,821**	**—**
Customer deposits and repurchase agreements	**27,572**	**27,651**	**—**	**27,651**	**—**
Due to fellow Lloyds Banking Group undertakings	**3,920**	**3,920**	**—**	**3,920**	**—**
Debt securities in issue	**16,644**	**16,723**	**—**	**16,723**	**—**
Subordinated liabilities	**684**	**684**	**—**	**684**	**—**
Repurchase agreements included in above amounts:					
Customer deposits and repurchase agreements	**1,019**	**1,019**	**—**	**1,019**	**—**
At 31 December 2020					
Deposits from banks	5,601	5,603	—	5,603	—
Customer deposits and repurchase agreements	25,061	25,160	—	25,160	—
Due to fellow Lloyds Banking Group undertakings	3,659	3,659	—	3,659	—
Debt securities in issue	15,602	15,849	—	15,849	—
Subordinated liabilities	686	686	—	686	—
Repurchase agreements included in above amounts:					
Customer deposits and repurchase agreements	—	—	—	—	—

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.

Note 32: Financial instruments (continued)

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.

(5) Reclassifications of financial assets
There have been no reclassifications of financial assets in 2020 or 2021.

Note 33: Offsetting of financial assets and liabilities

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

The Group				Related amounts where set off in the balance sheet not permitted[3]		Potential net amounts if offset of related amounts permitted
	Gross amounts of assets and liabilities[1]	Amount offset in the balance sheet[2]	Net amounts presented in the balance sheet	Cash collateral received/ pledged	Non-cash collateral received/ pledged	
	£m	£m	£m	£m	£m	£m
At 31 December 2021						
Financial assets						
Financial assets at fair value through profit or loss						
Excluding reverse repurchase agreements	7,488	—	7,488	—	(2,421)	5,067
Reverse repurchase agreements	34,049	(19,128)	14,921	—	(14,921)	—
	41,537	(19,128)	22,409	—	(17,342)	5,067
Derivative financial instruments	17,990	—	17,990	(3,744)	(11,236)	3,010
Loans and advances to banks and reverse repurchase agreements						
Excluding reverse repurchase agreements	2,354	—	2,354	(1,339)	—	1,015
Reverse repurchase agreements	536	—	536	—	(536)	—
	2,890	—	2,890	(1,339)	(536)	1,015
Loans and advances to customers and reverse repurchase agreements						
Excluding reverse repurchase agreements	17,432	—	17,432	(946)	—	16,486
Reverse repurchase agreements	4,508	—	4,508	—	(4,508)	—
	21,940	—	21,940	(946)	(4,508)	16,486
Debt securities	229	—	229	—	—	229
Financial assets at fair value through other comprehensive income	100	—	100	—	—	100
Financial liabilities						
Deposits from banks						
Excluding repurchase agreements	3,821	—	3,821	(2,387)	—	1,434
Repurchase agreements	—	—	—	—	—	—
	3,821	—	3,821	(2,387)	—	1,434
Customer deposits and repurchase agreements						
Excluding repurchase agreements	26,967	—	26,967	(1,357)	—	25,610
Repurchase agreements	1,019	—	1,019	—	(1,019)	—
	27,986	—	27,986	(1,357)	(1,019)	25,610
Financial liabilities at fair value through profit or loss:						
Excluding repurchase agreements	1,620	—	1,620	—	—	1,620
Repurchase agreements	34,090	(19,128)	14,962	—	(14,962)	—
	35,710	(19,128)	16,582	—	(14,962)	1,620
Derivative financial instruments	15,572	—	15,572	(2,285)	(12,051)	1,236

1 After impairment allowance.

2 The amounts offset in the balance sheet as shown above mainly represent derivatives and repurchase agreements with central clearing houses which meet the criteria for offsetting under IAS 32.

3 The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in 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.

Note 33: Offsetting of financial assets and liabilities (continued)

The Group	Gross amounts of assets and liabilities[1]	Amount offset in the balance sheet[2]	Net amounts presented in the balance sheet	Related amounts where set off in the balance sheet not permitted[3] Cash collateral received/ pledged	Non-cash collateral received/ pledged	Potential net amounts if offset of related amounts permitted
	£m	£m	£m	£m	£m	£m
At 31 December 2020						
Financial assets						
Financial assets at fair value through profit or loss						
Excluding reverse repurchase agreements	7,931	—	7,931	—	(2,565)	5,366
Reverse repurchase agreements	27,934	(14,939)	12,995	—	(12,995)	—
	35,865	(14,939)	20,926	—	(15,560)	5,366
Derivative financial instruments	21,757	—	21,757	(4,809)	(12,887)	4,061
Loans and advances to banks and reverse repurchase agreements						
Excluding reverse repurchase agreements	3,600	—	3,600	(2,065)	—	1,535
Reverse repurchase agreements	1,660	—	1,660	—	(1,660)	—
	5,260	—	5,260	(2,065)	(1,660)	1,535
Loans and advances to customers and reverse repurchase agreements						
Excluding reverse repurchase agreements	14,256	—	14,256	(1,801)	—	12,455
Reverse repurchase agreements	4,196	—	4,196	—	(4,196)	—
	18,452	—	18,452	(1,801)	(4,196)	12,455
Debt securities	257	—	257	—	—	257
Financial assets at fair value through other comprehensive income	149	—	149	—	—	149
Financial liabilities						
Deposits from banks						
Excluding repurchase agreements	5,601	—	5,601	(3,460)	—	2,141
Repurchase agreements	—	—	—	—	—	—
	5,601	—	5,601	(3,460)	—	2,141
Customer deposits and repurchase agreements						
Excluding repurchase agreements	25,497	—	25,497	(1,349)	—	24,148
Repurchase agreements	—	—	—	—	—	—
	25,497	—	25,497	(1,349)	—	24,148
Financial liabilities at fair value through profit or loss						
Excluding repurchase agreements	818	—	818	—	—	818
Repurchase agreements	29,936	(14,939)	14,997	—	(14,997)	—
	30,754	(14,939)	15,815	—	(14,997)	818
Derivative financial instruments	21,233	—	21,233	(3,865)	(15,066)	2,302

1 After impairment allowance.

2 The amounts offset in the balance sheet as shown above mainly represent derivatives and repurchase agreements with central clearing houses which meet the criteria for offsetting under IAS 32.

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

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

Note 34: 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, foreign exchange risk and credit spread risk; liquidity risk and capital risk. Information about the Group's exposure to each of the above risks and its capital can be found on pages 9 to 11. The following additional disclosures, which provide quantitative information about the risks within financial instruments held or issued by the Group, should be read in conjunction with that earlier information.

Credit risk

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

(A) Maximum credit exposure

The maximum credit risk exposure of the Group and the Bank 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.

	2021			2020		
The Group	**Maximum exposure £m**	**Offset[1] £m**	**Net exposure £m**	Maximum exposure £m	Offset[1] £m	Net exposure £m
Financial assets at fair value through profit or loss[2]:						
Loans and advances	**15,229**	**—**	**15,229**	13,348	—	13,348
Debt securities, treasury and other bills	**7,180**	**—**	**7,180**	7,575	—	7,575
	22,409	**—**	**22,409**	20,923	—	20,923
Derivative financial instruments	**17,990**	**(8,636)**	**9,354**	21,757	(10,055)	11,702
Financial assets at amortised cost, net[3]						
Loans and advances to banks and reverse repurchase agreements, net[3]	**2,890**	**—**	**2,890**	5,260	—	5,260
Loans and advances to customers and reverse repurchase agreements, net[3]	**21,940**	**—**	**21,940**	18,452	—	18,452
Debt securities, net[2]	**229**	**—**	**229**	257	—	257
	25,059	**—**	**25,059**	23,969	—	23,969
Financial assets at fair value through other comprehensive income	**100**	**—**	**100**	149	—	149
Off-balance sheet items:						
Acceptances and endorsements	**170**	**—**	**170**	57	—	57
Other items serving as direct credit substitutes	**77**	**—**	**77**	96	—	96
Performance bonds, including letters of credit, and other transaction-related contingencies	**158**	**—**	**158**	34	—	34
Irrevocable commitments and guarantees	**15,124**	**—**	**15,124**	14,416	—	14,416
	15,529	**—**	**15,529**	14,603	—	14,603
	81,087	**(8,636)**	**72,451**	81,401	(10,055)	71,346

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

2 Excluding equity shares.

3 Amounts shown net of related impairment allowances.

Note 34: Financial risk management (continued)

The Bank	2021 Maximum exposure £m	2021 Offset[1] £m	2021 Net exposure £m	2020 Maximum exposure £m	2020 Offset[1] £m	2020 Net exposure £m
Financial assets at fair value through profit or loss[2]:						
Loans and advances	**15,229**	**—**	**15,229**	13,348	—	13,348
Debt securities, treasury and other bills	**7,039**	**—**	**7,039**	7,490	—	7,490
	22,268	**—**	**22,268**	20,838	—	20,838
Derivative financial instruments	**18,042**	**(8,636)**	**9,406**	21,818	(10,055)	11,763
Financial assets at amortised cost, net[3]						
Loans and advances to banks and reverse repurchase agreements, net[3]	**2,869**	**—**	**2,869**	5,231	—	5,231
Loans and advances to customers and reverse repurchase agreements, net[3]	**21,684**	**—**	**21,684**	18,189	—	18,189
Debt securities, net[3]	**229**	**—**	**229**	257	—	257
	24,782	**—**	**24,782**	23,677	—	23,677
Financial assets at fair value through other comprehensive income	**100**	**—**	**100**	149	—	149
Off-balance sheet items:						
Acceptances and endorsements	**170**	**—**	**170**	57	—	57
Other items serving as direct credit substitutes	**77**	**—**	**77**	96	—	96
Performance bonds, including letters of credit, and other transaction-related contingencies	**158**	**—**	**158**	34	—	34
Irrevocable commitments and guarantees	**15,124**	**—**	**15,124**	14,416	—	14,416
	15,529	**—**	**15,529**	14,603	—	14,603
	80,721	**(8,636)**	**72,085**	81,085	(10,055)	71,030

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

2 Excluding equity shares.

3 Amounts shown net of related impairment allowances.

(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. As part of its credit risk policy, the Group considers sustainability risk (which incorporates Environmental (including climate), Social and Governance) in the assessment of Commercial Banking facilities.

At 31 December 2021 the most significant concentration of exposure was in financial, business and other services (comprising 85 per cent of total loans and advances to customers).

Loans and advances to customers and reverse repurchase agreements

	The Group 2021 £m	The Group 2020 £m	The Bank 2021 £m	The Bank 2020 £m
Agriculture, forestry and fishing	**—**	1	**—**	1
Energy and water supply	**16**	38	**16**	38
Manufacturing	**605**	502	**605**	502
Construction	**115**	50	**115**	50
Transport, distribution and hotels	**97**	112	**97**	112
Postal and telecommunications	**253**	404	**253**	404
Property companies	**756**	984	**756**	984
Financial, business and other services	**18,604**	15,008	**18,604**	15,008
Personal:				
Mortgages	**1,232**	1,120	**1,232**	1,120
Other	**58**	69	**16**	17
Lease financing	**138**	134	**—**	—
Hire purchase	**76**	78	**—**	—
Total loans and advances to customers and reverse repurchase agreements before allowance for impairment losses	**21,950**	18,500	**21,694**	18,236
Allowance for impairment losses (note 13)	**(10)**	(48)	**(10)**	(47)
Total loans and advances to customers and reverse repurchase agreements	**21,940**	18,452	**21,684**	18,189

Note 34: Financial risk management (continued)

(C) Credit quality of assets

Loans and advances

The analysis of lending has been prepared with the business segment in which the exposure is recorded reflected in the ratings system applied. The internal credit ratings systems used by the Group for commercial business reflects the characteristics of these exposures and the way that they are managed internally; these credit ratings are set out below. All probabilities of default (PDs) include forward-looking information and are based on 12 month values, with the exception of credit impaired.

Commercial	
Quality classification	**IFRS 9 PD Range**
CMS 1-10	0.00-0.50%
CMS 11-14	0.51-3.00%
CMS 15-18	3.01-20.00%
CMS 19	20.01-99.99%
CMS 20-23	100.00%

The Group - Gross drawn exposures and expected credit loss allowances	Drawn exposures				Expected credit loss allowance			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2021								
Loans and advances to banks and reverse repurchase agreements								
CMS 1-10	**2,855**	**—**	**—**	**2,855**	**1**	**—**	**—**	**1**
CMS 11-14	**36**	**—**	**—**	**36**	**—**	**—**	**—**	**—**
CMS 15-18	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 19	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 20-23	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
	2,891	**—**	**—**	**2,891**	**1**	**—**	**—**	**1**
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	**21,288**	**7**	**—**	**21,295**	**5**	**—**	**—**	**5**
CMS 11-14	**583**	**13**	**—**	**596**	**2**	**—**	**—**	**2**
CMS 15-18	**3**	**25**	**—**	**28**	**—**	**2**	**—**	**2**
CMS 19	**—**	**2**	**—**	**2**	**—**	**—**	**—**	**—**
CMS 20-23	**—**	**—**	**29**	**29**	**—**	**—**	**1**	**1**
	21,874	**47**	**29**	**21,950**	**7**	**2**	**1**	**10**

The Group - Gross drawn exposures and expected credit loss allowances	Drawn exposures				Expected credit loss allowance			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2020								
Loans and advances to banks and reverse repurchase agreements								
CMS 1-10	5,211	—	—	5,211	2	—	—	2
CMS 11-14	51	—	—	51	—	—	—	—
CMS 15-18	—	—	—	—	—	—	—	—
CMS 19	—	—	—	—	—	—	—	—
CMS 20-23	—	—	—	—	—	—	—	—
	5,262	—	—	5,262	2	—	—	2
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	17,273	13	—	17,286	20	—	—	20
CMS 11-14	800	311	—	1,111	6	3	—	9
CMS 15-18	9	39	—	48	—	2	—	2
CMS 19	—	16	—	16	—	15	—	15
CMS 20-23	—	—	39	39	—	—	2	2
	18,082	379	39	18,500	26	20	2	48

Note 34: Financial risk management (continued)

The Group - Gross undrawn exposures and expected credit loss allowance	Undrawn exposures				Expected credit loss allowance			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2021								
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	**14,502**	**—**	**—**	**14,502**	**3**	**—**	**—**	**3**
CMS 11-14	**689**	**—**	**—**	**689**	**3**	**—**	**—**	**3**
CMS 15-18	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 19	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 20-23	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
	15,191	**—**	**—**	**15,191**	**6**	**—**	**—**	**6**

The Group - Gross undrawn exposures and expected credit loss allowance	Undrawn exposures				Expected credit loss allowance			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2020								
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	13,203	—	—	13,203	18	—	—	18
CMS 11-14	510	798	—	1,308	2	12	—	14
CMS 15-18	—	24	—	24	—	1	—	1
CMS 19	—	—	—	—	—	—	—	—
CMS 20-23	—	—	—	—	—	—	—	—
	13,713	822	—	14,535	20	13	—	33

The Bank - Gross drawn exposures and expected credit loss allowances	Drawn exposures				Expected credit loss allowance			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2021								
Loans and advances to banks and reverse repurchase agreements								
CMS 1-10	**2,834**	**—**	**—**	**2,834**	**1**	**—**	**—**	**1**
CMS 11-14	**36**	**—**	**—**	**36**	**—**	**—**	**—**	**—**
CMS 15-18	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 19	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 20-23	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
	2,870	**—**	**—**	**2,870**	**1**	**—**	**—**	**1**
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	**21,064**	**2**	**—**	**21,066**	**5**	**—**	**—**	**5**
CMS 11-14	**560**	**10**	**—**	**570**	**2**	**—**	**—**	**2**
CMS 15-18	**3**	**24**	**—**	**27**	**—**	**2**	**—**	**2**
CMS 19	**—**	**2**	**—**	**2**	**—**	**—**	**—**	**—**
CMS 20-23	**—**	**—**	**29**	**29**	**—**	**—**	**1**	**1**
	21,627	**38**	**29**	**21,694**	**7**	**2**	**1**	**10**

Note 34: Financial risk management (continued)

The Bank - Gross drawn exposures and expected credit loss allowances	Drawn exposures Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Expected credit loss allowance Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2020								
Loans and advances to banks and reverse repurchase agreements								
CMS 1-10	5,182	—	—	5,182	2	—	—	2
CMS 11-14	51	—	—	51	—	—	—	—
CMS 15-18	—	—	—	—	—	—	—	—
CMS 19	—	—	—	—	—	—	—	—
CMS 20-23	—	—	—	—	—	—	—	—
	5,233	—	—	5,233	2	—	—	2
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	17,158	2	—	17,160	19	—	—	19
CMS 11-14	666	308	—	974	6	3	—	9
CMS 15-18	9	39	—	48	—	2	—	2
CMS 19	—	15	—	15	—	15	—	15
CMS 20-23	—	—	39	39	—	—	2	2
	17,833	364	39	18,236	25	20	2	47

The Bank - Gross undrawn exposures and expected credit loss allowances	**Undrawn exposures Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Expected credit loss allowance Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
At 31 December 2021								
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	**14,502**	**—**	**—**	**14,502**	**3**	**—**	**—**	**3**
CMS 11-14	**689**	**—**	**—**	**689**	**3**	**—**	**—**	**3**
CMS 15-18	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 19	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CMS 20-23	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
	15,191	**—**	**—**	**15,191**	**6**	**—**	**—**	**6**

The Bank - Gross undrawn exposures and expected credit loss allowances	Undrawn exposures Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Expected credit loss allowance Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2020								
Loans and advances to customers and reverse repurchase agreements								
CMS 1-10	13,203	—	—	13,203	18	—	—	18
CMS 11-14	510	798	—	1,308	2	12	—	14
CMS 15-18	—	24	—	24	—	1	—	1
CMS 19	—	—	—	—	—	—	—	—
CMS 20-23	—	—	—	—	—	—	—	—
	13,713	822	—	14,535	20	13	—	33

Note 34: Financial risk management (continued)

Debt securities held at amortised cost
An analysis by credit rating of debt securities held at amortised cost is provided below:

	2021			2020		
	Investment grade[1]	Other	Total	Investment grade[1]	Other	Total
The Group and the Bank	£m	£m	£m	£m	£m	£m
Corporate and other debt securities	**229**	**—**	**229**	257	—	257
Gross exposure	**229**	**—**	**229**	257	—	257
Allowance for impairment losses			**—**			—
Total debt securities held at amortised cost			**229**			257

1 Credit ratings equal to or better than 'BBB'.

Financial assets at fair value through other comprehensive income
An analysis of financial assets at fair value through other comprehensive income is included in note 15. The credit quality of financial assets at fair value through other comprehensive income is set out below:

	2021			2020		
	Investment grade[1]	Other	Total	Investment grade[1]	Other	Total
The Group and the Bank	£m	£m	£m	£m	£m	£m
Debt securities:						
Asset-backed securities:						
Other asset-backed securities	**15**	**—**	**15**	113	—	113
	15	**—**	**15**	113	—	113
Treasury and other bills	**85**	**—**	**85**	36	—	36
Total financial assets at fair value through other comprehensive income	**100**	**—**	**100**	149	—	149

1 Credit ratings equal to or better than 'BBB'.

Note 34: Financial risk management (continued)

Debt securities, treasury and other bills held at fair value through profit or loss
An analysis of financial assets at fair value through profit or loss is included in note 11. Substantially all of the loans and advances to customers and banks recognised at fair value through profit or loss have a good quality rating. The credit quality of debt securities, treasury and other bills held at fair value through profit or loss is set out below.

The Group	2021 Investment grade[1] £m	2021 Other[2] £m	2021 Total £m	2020 Investment grade[1] £m	2020 Other[2] £m	2020 Total £m
Trading assets:						
Debt securities:						
Government securities	**6,580**	**—**	**6,580**	6,983	—	6,983
Asset-backed securities:						
Mortgage-backed securities	**12**	**—**	**12**	4	3	7
Other asset-backed securities	**3**	**—**	**3**	—	4	4
Corporate and other debt securities	**244**		**244**	225	21	246
Total trading assets	**6,839**	**—**	**6,839**	7,212	28	7,240
Other financial assets mandatorily at fair value through profit or loss:						
Debt securities:						
Bank and building society certificates of deposit	**122**	**—**	**122**	66	—	66
Corporate and other debt securities	**—**	**188**	**188**	—	223	223
	122	**188**	**310**	66	223	289
Treasury and other bills	**19**	**—**	**19**	19	—	19
Total other financial assets mandatorily at fair value through profit or loss	**141**	**188**	**329**	85	223	308
	6,980	**188**	**7,168**	7,297	251	7,548
Due from fellow Lloyds Banking Group undertakings:						
Corporate and other debt securities			**12**			27
Total held at fair value through profit or loss			**7,180**			7,575

1 Credit ratings equal to or better than 'BBB'.
2 Other comprises sub-investment grade (2021: £188 million; 2020: £nil) and not rated (2021: £nil; 2020: £251 million).

The Bank	2021 Investment grade[1] £m	2021 Other[2] £m	2021 Total £m	2020 Investment grade[1] £m	2020 Other[2] £m	2020 Total £m
Trading assets:						
Debt securities:						
Government securities	**6,580**	**—**	**6,580**	6,983	—	6,983
Asset-backed securities:						
Mortgage-backed securities	**12**	**—**	**12**	4	3	7
Other asset-backed securities	**3**	**—**	**3**	—	4	4
Corporate and other debt securities	**244**	**—**	**244**	225	21	246
Total trading assets	**6,839**	**—**	**6,839**	7,212	28	7,240
Other financial assets mandatorily at fair value through profit or loss:						
Debt securities:						
Corporate and other debt securities	**—**	**188**	**188**	—	223	223
Total other financial assets mandatorily at fair value through profit or loss	**—**	**188**	**188**	—	223	223
	6,839	**188**	**7,027**	7,212	251	7,463
Due from fellow Lloyds Banking Group undertakings:						
Corporate and other debt securities			**12**			27
Total held at fair value through profit or loss			**7,039**			7,490

1 Credit ratings equal to or better than 'BBB'.
2 Other comprises sub-investment grade (2021: £188 million; 2020: £nil) and not rated (2021: £nil; 2020: £251 million).

Note 34: Financial risk management (continued)

Derivative assets
An analysis of derivative assets is given in note 12. The credit quality of derivatives are set out below.

	2021			2020		
	Investment grade[1]	**Other[2]**	**Total**	Investment grade[1]	Other[2]	Total
The Group	**£m**	**£m**	**£m**	£m	£m	£m
Trading and other	**15,018**	**871**	**15,889**	17,912	928	18,840
Hedging	**7**	**—**	**7**	6	—	6
	15,025	**871**	**15,896**	17,918	928	18,846
Due from fellow Lloyds Banking Group undertakings			**2,094**			2,911
Total derivative financial instruments			**17,990**			21,757

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2021: £850 million; 2020: £530 million) and not rated (2021: £21 million; 2020: £398 million).

	2021			2020		
	Investment grade[1]	**Other[2]**	**Total**	Investment grade[1]	Other[2]	Total
The Bank	**£m**	**£m**	**£m**	£m	£m	£m
Trading and other	**15,018**	**871**	**15,889**	17,912	928	18,840
Hedging	**7**	**—**	**7**	6	—	6
	15,025	**871**	**15,896**	17,918	928	18,846
Due from fellow Lloyds Banking Group undertakings			**2,146**			2,972
Total derivative financial instruments			**18,042**			21,818

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2021: £850 million; 2020: £530 million) and not rated (2021: £21 million; 2020: £398 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 principal types of collateral accepted by the Group include: commercial and residential properties; charges over business assets such as premises, inventory and accounts receivable; financial instruments, cash and guarantees from third-parties. The terms and conditions associated with the use of the collateral are varied and are dependent on the type of agreement and the counterparty. The Group holds collateral against loans and advances and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for financial assets at fair value through profit or loss and for derivative assets is also shown below.

The Group holds collateral in respect of loans and advances to banks and customers as set out below. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as financial assets held at amortised cost.

Loans and advances to banks and reverse repurchase agreements
There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £536 million for the Group and the Bank (2020: £1,660 million for the Group and the Bank), against which the Group and the Bank held collateral with a fair value of £529 million (2020: £1,642 million for the Group and the Bank).

These transactions were generally conducted under terms that are usual and customary for standard reverse repurchase activities.

Loans and advances to customers and reverse repurchase agreements
Commercial lending
Reverse repurchase transactions
At 31 December 2021 there were reverse repurchase agreements which were accounted for as collateralised loans with a carrying value of £4,508 million for the Group and the Bank (2020: £4,196 million for the Group and the Bank) against which the Group and the Bank held collateral with a fair value of £4,479 million (2020: £4,126 million) all of which the Group was able to repledge. These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Stage 3 secured lending
At 31 December 2021, Stage 3 secured commercial lending amounted to £28 million, net of an impairment allowance of £1 million for the Group and the Bank (2020: £nil, net of an impairment allowance of £1 million for the Group and the Bank). The fair value of the collateral held in respect of stage 3 secured commercial lending was £nil (2020: £nil).

Financial assets at fair value through profit or loss (excluding equity shares)
Included in financial assets at fair value through profit or loss are reverse repurchase agreements treated as collateralised loans with a carrying value of £14,921 million for the Group and the Bank (2020: £12,995 million). Collateral is held with a fair value of £15,849 million for the Group and the Bank, all of which the Group is able to repledge (2020: £13,199 million for the Group and the Bank). At 31 December 2021, £13,620 million had been repledged (2020: £9,665 million).

Note 34: Financial risk management (continued)

In addition, securities held as collateral in the form of stock borrowed amounted to £10,384 million for the Group and the Bank (2020: £22,923 million for the Group and the Bank). Of this amount, £8,923 million for the Group and the Bank (2020: £21,631 million for the Group and the Bank) had been resold or repledged as collateral for the Group's own transactions.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Derivative assets, after offsetting of amounts under master netting arrangements
The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £9,354 million for the Group and £9,406 million for the Bank (2020: £11,702 million for the Group and £11,763 million for the Bank), cash collateral of £3,744 million for the Group and the Bank (2020: £4,809 million for the Group and the Bank) was held. and a further £185 million for the Group and the Bank (2020: £303 million for the Group and the Bank) was due from OECD banks.

Irrevocable loan commitments and other credit-related contingencies
At 31 December 2021, there were irrevocable loan commitments and other credit-related contingencies of £15,529 million for the Group and Bank (2020: £14,603 million for the Group and the Bank)

(E) Collateral pledged as security

The Group transfers and lends 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
Amortised cost
There are balances arising from repurchase transactions with customers of £1,019 million (2020: £nil), the fair value of the collateral provided under these agreements at 31 December 2021 was £1,000 million (2020: £nil).

Financial liabilities at fair value through profit or loss
The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowing, where the secured party is permitted by contract or custom to repledge was £14,441 million for the Group and the Bank at 31 December 2021 (2020: £12,608 million for the Group and the Bank).

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

	The Group and the Bank	
	2021	2020
	£m	£m
Financial assets at fair value through profit or loss	**2,695**	3,724
	2,695	3,724

Market risk

Trading Portfolios
Exposures
The Group's trading activity is small relative to its peers. The Group's trading activity is undertaken to meet the financial requirements of commercial customers for foreign exchange, credit and interest rate products. These activities support customer flow and market making activities.

While the trading positions taken are generally small, any extreme moves in the main risk factors and other related risk factors could cause significant losses in the trading book depending on the positions at the time. The average 95 per cent 1-day trading VaR (Value at Risk; diversified across risk factors) was £1.0 million for 31 December 2021 compared to £0.8 million for 31 December 2020.

Trading market risk measures are applied to all of the Group's regulatory trading books and they include daily VaR, sensitivity-based measures, and stress testing calculations.

Measurement
The Group internally uses VaR as the primary risk measure for all trading book positions.

The risk of loss measured by the VaR model is the minimum expected loss in earnings given the 95 per cent confidence.

Note 34: Financial risk management (continued)

Trading portfolios: VaR (1-day 95 per cent confidence level) (audited)

	At 31 December 2021				At 31 December 2020			
	Close	**Average**	**Maximum**	**Minimum**	Close	Average	Maximum	Minimum
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Interest rate risk	**0.8**	**0.9**	**1.6**	**0.5**	1.0	0.8	1.2	0.4
Foreign exchange risk	**—**	**0.1**	**0.4**	**—**	0.3	0.1	0.3	—
Equity risk	**—**	**—**	**—**	**—**	—	—	—	—
Credit spread risk	**0.1**	**0.1**	**0.2**	**—**	0.2	0.2	0.3	0.1
Inflation risk	**0.2**	**0.3**	**0.8**	**0.2**	0.1	0.2	0.4	0.1
All risk factors before diversification	**1.1**	**1.4**	**2.4**	**1.0**	1.6	1.3	1.7	0.8
Portfolio diversification	**(0.2)**	**(0.4)**	**—**	**—**	(0.6)	(0.5)	—	—
Total VaR	**0.9**	**1.0**	**2.0**	**0.6**	1.0	0.8	1.2	0.4

The market risk for the trading book continues to be low relative to the size of the Group and in comparison to peers. This reflects the fact that the Group's trading operations are customer-centric and focused on hedging and recycling client risks.

Although it is an important market standard measure of risk, VaR has limitations. One of them is the use of a limited historical data sample which influences the output by the implicit assumption that future market behaviour will not differ greatly from the historically observed period. Another known limitation is the use of defined holding periods which assumes that the risk can be liquidated or hedged within that holding period. Also calculating the VaR at the chosen confidence interval does not give enough information about potential losses which may occur if this level is exceeded. The Group fully recognises these limitations and supplements the use of VaR with a variety of other measurements which reflect the nature of the business activity. These include detailed sensitivity analysis, position reporting and a stress testing programme.

Trading book VaR (1-day 99 per cent) is compared daily against both hypothetical and actual profit and loss. The 1-day 99 per cent VaR charts for the Group can be found in Lloyds Banking Group's Pillar 3 Report.

Mitigation
The level of exposure is controlled by establishing and communicating the approved risk limits and controls through policies and procedures that define the responsibility and authority for risk taking. Market risk limits are clearly and consistently communicated to the business. Any new or emerging risks are brought within risk reporting and defined limits.

Monitoring
Trading risk appetite is monitored daily with 1-day 95 per cent VaR and stress testing limits. These limits are complemented with position level action triggers and profit and loss referrals. Risk and position limits are set and managed at both desk and overall trading book levels. They are reviewed at least annually and can be changed as required within the overall Group risk appetite framework.

Banking Activities
Exposures
The Group's banking activities expose it to the risk of adverse movements in market rates or prices, predominantly interest rates, credit spread and exchange rates. The volatility of market rates or prices can be affected by both the transparency of prices and the amount of liquidity in the market for the relevant asset, liability or instrument.

Interest rate risk
Yield curve risk in the Group's international portfolios, and in the Group's capital and funding activities, arises from the different repricing characteristics of the Group's non-trading assets, liabilities and off-balance sheet positions.

Basis risk arises from the potential changes in spreads between indices, for example where the bank lends with reference to a central bank rate but funds with reference to a market rate, e.g. SONIA, and the spread between these two rates widens or tightens.

Optionality risk arises predominantly from embedded optionality within assets, liabilities or off-balance sheet items where either the Group or the customer can affect the size or timing of cash flows.

Foreign exchange risk
Economic foreign exchange exposure arises from the Group's investment in its overseas operations. In addition, the Group incurs foreign exchange risk through non-functional currency flows from services provided by customer-facing divisions, the Group's debt and capital management programmes and is exposed to volatility in its CET1 ratio, due to the impact of changes in foreign exchange rates on the retranslation of non-Sterling-denominated risk-weighted assets.

Credit spread risk
Credit spread risk arises largely from: (i) the Credit Valuation Adjustment (CVA), Debit Valuation Adjustment (DVA) and Funding Valuation Adjustment (FVA) sensitivity to credit spreads; and (ii) banking book assets held at fair value under IFRS 9.

Measurement
Interest rate risk exposure is monitored monthly using, primarily:

Market value sensitivity: this methodology considers all repricing mismatches (behaviourally adjusted where appropriate) in the current balance sheet and calculates the change in market value that would result from an instantaneous 25, 100 and 200 basis points parallel rise or fall in the yield curve. Sterling interest rates are modelled with a floor below zero per cent, with negative rate floors also modelled for non-Sterling currencies where appropriate (product-specific floors apply). The market value sensitivities are calculated on a static balance sheet using principal cash flows excluding interest, commercial margins and other spread components and are therefore discounted at the risk-free rate.

Interest income sensitivity: this measures the impact on future net interest income arising from various economic scenarios. These include instantaneous 25, 100 and 200 basis point parallel shifts in all yield curves and the Group economic scenarios. Sterling interest rates are modelled with a floor below zero per cent, with negative rate floors also modelled for non-Sterling currencies where appropriate (product-specific floors apply). These scenarios are reviewed every year and are designed to replicate severe but plausible economic events, capturing risks that would not be evident through the use of parallel shocks alone such as basis risk and steepening or flattening of the yield curve.

Note 34: Financial risk management (continued)

Additional negative rate scenarios are also used, where floors are removed, to ensure that this risk is monitored; however, these are not measured against the limit framework for the purposes of risk appetite.

Unlike the market value sensitivities, the interest income sensitivities incorporate additional behavioural assumptions as to how and when individual products would reprice in response to changing rates.

Reported sensitivities are not necessarily predictive of future performance as they do not capture additional management actions that would likely be taken in response to an immediate, large, movement in interest rates. These actions could reduce the net interest income sensitivity, help mitigate any adverse impacts or they may result in changes to total income that are not captured in the net interest income.

Structural hedge: the structural hedging programme managing interest rate risk in the banking book relies on assumptions made around customer behaviour. A number of metrics are in place to monitor the risks within the portfolio.

The Group has an integrated Asset and Liability Management (ALM) system which supports non-traded asset and liability management of the Group. This provides a single consolidated tool to measure and manage interest rate repricing profiles (including behavioural assumptions), perform stress testing and produce forecast outputs. The Group is aware that any assumptions-based model is open to challenge. A full behavioural review is performed annually, or in response to changing market conditions, to ensure the assumptions remain appropriate and the model itself is subject to annual re-validation, as required under Lloyds Banking Group's model governance policy. The key behavioural assumptions are:

– Embedded optionality within products
– The duration of balances that are contractually repayable on demand, such as current accounts and overdrafts, together with net free reserves of the Group
– The re-pricing behaviour of managed rate liabilities, such as variable rate savings

The table below shows, split by material currency, the Group's market value sensitivities to an instantaneous parallel up and down 25 and 100 basis points change to all interest rates.

Banking activities: market value sensitivity (audited)

	2021				2020			
	Up 25bps £m	**Down 25bps £m**	**Up 100bps £m**	**Down 100bps £m**	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m
Sterling	**(3.5)**	**3.6**	**(13.5)**	**17.8**	(2.3)	0.8	(8.8)	0.9
US Dollar	**(0.8)**	**0.3**	**(3.3)**	**0.1**	0.6	(0.5)	2.3	(0.5)
Euro	**0.3**	**(0.2)**	**1.0**	**(0.3)**	0.5	(0.5)	1.9	(0.5)
Other	**—**	**—**	**—**	**—**	—	—	—	—
Total	**(4.0)**	**3.7**	**(15.8)**	**17.6**	(1.2)	(0.2)	(4.6)	(0.1)

This is a risk-based disclosure and the amounts shown would be amortised in the income statement over the duration of the portfolio.

The market value sensitivity to an up 100 basis points shock has increased due to the impacts of mortgage hedging and changes to the treatment of customer balances.

The table below shows supplementary value sensitivity to a steepening and flattening (c.100 basis points around the three-year point) in the yield curve. This ensures there are no unintended consequences to managing risk to parallel shifts in rates.

Banking activities: market value sensitivity to a steepening and flattening of the yield curve (audited)

	2021		2020	
	Steepener £m	**Flattener £m**	Steepener £m	Flattener £m
Sterling	**(4.9)**	**6.7**	(4.3)	2.1
US Dollar	**0.3**	**(2.7)**	(0.2)	1.1
Euro	**(0.2)**	**0.5**	(0.6)	1.8
Other	**—**	**—**	—	—
Total	**(4.8)**	**4.5**	(5.1)	5.0

The table below shows the banking book one year net interest income sensitivity to an instantaneous parallel up and down 25 basis points change to all interest rates.

Banking activities: net interest income sensitivity (audited)

	2021		2020	
	Up 25bps £m	**Down 25bps £m**	Up 25bps £m	Down 25bps £m
Client facing activity and associated hedges	**4.1**	**(8.7)**	6.7	0.2

Note 34: Financial risk management (continued)

The table below shows supplementary income sensitivity on a one to three-year forward-looking basis to an instantaneous parallel up 25, down 25 and up 50 basis points change to all interest rates.

Banking activities: three year net interest income sensitivity (audited)

	2021								
	Up 25bps			Down 25bps			Up 50bps		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Client-facing activity and associated hedges	**4.1**	**1.3**	**5.1**	**(8.7)**	**(5.7)**	**(9.5)**	**10.9**	**5.6**	**13.1**

The increase in risk sensitivity year-on-year, to down 25 basis points, is driven by greater modelled margin compression risk following the rise in interest rates in December 2021. This results in the full 25 basis points downshock being applied at December 2021 whereas a 10 basis points shock was applied at December 2020 due to the Group's assumption, at the time, for modelling Sterling interest rates with a floor of zero per cent (product-specific floors apply).

The three year net interest income sensitivity to a down 25 basis points shock is driven predominantly by margin compression. The sensitivity to an up 25 basis points and 50 basis points shock is largely due to reinvestment of structural hedge maturities.

The sensitivities are illustrative and do not reflect new business margin implications and/or pricing actions, other than as outlined.

The following assumptions have been applied:

– Instantaneous parallel shift in interest rate curve, including bank base rate
– Balance sheet remains constant
– Illustrative 50 per cent deposit pass-through

Basis risk, foreign exchange and credit spread risks are measured primarily through scenario analysis by assessing the impact on profit before tax over a 12-month horizon arising from a change in market rates, and reported within the Board risk appetite on a monthly basis. Supplementary measures such as sensitivity and exposure limits are applied where they provide greater insight into risk positions. Frequency of reporting supplementary measures varies from daily to quarterly appropriate to each risk type.

Mitigation
The Group's policy is to optimise reward while managing its market risk exposures within the risk appetite defined by the Board. Lloyds Banking Group's market risk policy and procedures outlines the hedging process, and the centralisation of risk from divisions into Group Corporate Treasury (GCT), e.g. via the transfer pricing framework. GCT is responsible for managing the centralised risk and does this through natural offsets of matching assets and liabilities, and appropriate hedging activity of the residual exposures, subject to the authorisation and mandate of LBCM ALCO within the Board risk appetite. The hedges are externalised to the market through LBCM Treasury and trading desks. The Group mitigates income statement volatility through hedge accounting. This reduces the accounting volatility arising from the Group's economic hedging activities and any hedge accounting ineffectiveness is continuously monitored.

The largest residual risk exposure arises from balances that are deemed to be insensitive to changes in market rates (including current accounts, a portion of variable rate deposits and investable equity), and is managed through the Group's structural hedge. Consistent with the Group's strategy to deliver stable returns, LBCM ALCO seeks to minimise large reinvestment risk, and to smooth earnings over a range of investment tenors. The structural hedge consists of longer-term fixed rate assets or interest rate swaps and the amount and duration of the hedging activity is reviewed regularly by LBCM ALCO.

While the bank faces margin compression in low rate environments, its exposure to pipeline and prepayment risk are not considered material and are hedged in line with expected customer behaviour. These are appropriately monitored and controlled through international Asset and Liability Committees (ALCOs).

Net investment foreign exchange exposures are managed centrally by GCT, by hedging non-Sterling asset values with currency borrowing. Economic foreign exchange exposures arising from non-functional currency flows are identified by international locations and transferred and managed centrally. The Group also has a policy of forward hedging its forecasted currency profit and loss to year end. The Group makes use of both accounting and economic foreign exchange exposures, as an offset against the impact of changes in foreign exchange rates on the value of non-Sterling-denominated risk-weighted assets. This involves the holding of a structurally open currency position; sensitivity is minimised where, for a given currency, the ratio of the structural open position to risk-weighted assets equals the CET1 ratio. Continually evaluating this structural open currency position against evolving non-Sterling-denominated risk-weighted assets mitigates volatility in the Group's CET1 ratio.

Monitoring
The appropriate limits and triggers are monitored by senior executive committees within the Banking divisions and approved by the Board. Banking assets, liabilities and associated hedging are actively monitored and if necessary rebalanced to be within agreed tolerances.

(A) Interest rate risk

Interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the UK Bank Rate, set by the Bank of England. The rates on the remaining deposits are contractually fixed for their term to maturity.

The Group's risk management policy is to optimise reward whilst managing its market risk exposures within the risk appetite defined by the Board. The largest residual risk exposure arises from balances that are deemed to be insensitive to changes in market rates (including current accounts, a portion of variable rate deposits and investable equity), and is managed through the Group's structural hedge. The structural hedge consists of longer-term fixed rate assets or interest rate swaps and the amount and duration of the hedging activity is reviewed regularly by the LBCM ALCO.

The Group and the Bank establish hedge accounting relationships for interest rate risk using cash flow hedges and fair value hedges. The Group and the Bank are exposed to cash flow interest rate risk on their variable rate loans and deposits together with their floating rate debt. The derivatives used to manage the structural hedge may be designated into cash flow hedges to manage income statement volatility. The economic items related to the structural hedge, for example current accounts, are not eligible hedged items under IAS 39 for inclusion into accounting hedge relationships. The Group and the Bank are exposed to fair value interest rate risk on their fixed rate customer loans, their

Note 34: Financial risk management (continued)

fixed rate customer deposits and the majority of their subordinated debt. The Group and the Bank apply netting between similar risks before applying hedge accounting.

Hedge ineffectiveness arises during the management of interest rate risk due to residual unhedged risk. Sources of ineffectiveness, which the Group may decide to not fully mitigate, can include basis differences, timing differences and notional amount differences. The effectiveness of accounting hedge relationships is assessed between the hedging derivatives and the documented hedged item, which can differ to the underlying economically hedged item.

At 31 December 2021 the aggregate notional principal of interest rate swaps designated as fair value hedges was £7,414 million (2020: £7,700 million) for the Group and the Bank with a net fair value liability of £1 million (2020: asset of £1 million) for the Group and the Bank (note 12). There were losses recognised on the hedging instruments of £142 million (2020: gains of £121 million) for the Group and the Bank. There were gains on the hedged items attributable to the hedged risk of £141 million (2020: losses of £123 million) for the Group and the Bank. The gains and losses relating to the fair value hedges are recorded in net trading income.

In addition the Group has cash flow hedges which are primarily used to hedge the variability in the cost of funding within the commercial business. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2021 was £13,571 million (2020: £9,750 million) for the Group and the Bank with a net fair value asset of £5 million (2020: asset of £2 million) (note 12). In 2021, ineffectiveness recognised in the income statement that arises from cash flow hedges was a loss of £12 million (2020: gain of £10 million) for the Group and the Bank.

Interest Rate Benchmark Reform

During 2021, the Group has continued to manage the transition to alternative benchmark rates under its Group-wide IBOR transition programme including delivery of the core changes required to its technology and business processes. Through this programme, the Group has ensured that the most appropriate benchmark rate is used for new products, has transitioned the vast majority of its legacy products to new benchmark rates for IBORs ceasing immediately after 31 December 2021 and has managed the impacts and risks relating to systems, processes, accounting and reporting. The Group does not expect material changes to its risk management approach and strategy as a result of interest rate benchmark reform.

The material risks identified include the following:

Conduct and litigation risk. The Group may be exposed to conduct and litigation charges as a direct result of inappropriate or negligent actions taken during IBOR transition resulting in detriment to the customer. The Group is working closely with its counterparties to avoid this outcome.

Market risk. IBOR transition is expected to lead to changes in the Group's market risk profile which will continue to be monitored and managed within the appropriate risk appetites. The key change is expected to be on the management of basis risk profile during the period when alternative benchmark rates are referenced in contracts up to the cessation of the in-scope IBOR index.

Credit risk. Clients may wish to renegotiate the terms of existing transactions as a consequence of IBOR reform. This could lead to a change in the credit risk exposure of the client depending on the outcome of the negotiations. The Group will continue to monitor and manage changes within the appropriate risk appetites.

Accounting risk. If IBOR transition is finalised in a manner that does not permit the application of the reliefs introduced in the IFRS Phase 2 amendments, the financial instrument may be required to be derecognised and a new instrument recognised. In addition, where instruments used in hedge accounting relationships are transitioned either at different times or to different benchmarks, this may result in additional volatility to the income statement either through hedge accounting ineffectiveness or failure of the hedge accounting relationships.

Operational risk. Additional operational risks may arise due to the IBOR transition programme impacting all businesses and functions within the Group and leading to the implementation of changes to technology, operations, client communication and the valuation of in-scope financial instruments.

At 31 December 2021, the Group had successfully transitioned all derivative products settled though the London Clearing House (LCH) that were dependent on Sterling, Euro, Japanese Yen and Swiss Franc LIBOR to alternative benchmark rates and has transitioned the majority of its commercial lending contracts from Sterling LIBOR to alternative benchmark rates. US Dollar LIBOR is not expected to cease before 30 June 2023 and the Group continues to work on its planned transition to alternative benchmark rates for those financial contracts currently referencing US dollar LIBOR.

At 31 December 2021, the Group and the Bank had the following significant exposures impacted by interest rate benchmark reform which have yet to transition to the replacement benchmark:

	The Group			The Bank		
	GBP LIBOR	USD LIBOR	Other LIBOR	GBP LIBOR	USD LIBOR	Other LIBOR
	£m	£m	£m	£m	£m	£m
Non-derivative financial assets						
Financial assets at fair value through profit or loss	189	96	—	189	96	—
Loans and advances to banks	—	854	—	—	854	—
Loans and advances to customers	123	3,426	—	123	3,426	—
Debt securities	126	—	—	126	—	—
Financial assets at amortised cost	249	4,280	—	249	4,280	—
Financial assets at fair value through other comprehensive income	15	—	—	15	—	—
Non-derivative financial liabilities						
Customer deposits	—	74	—	—	74	—
Subordinated liabilities	—	558	—	—	558	—
Derivative notional/contract amount						
Cross Currency	—	36,212	—	—	36,212	—
Interest rate	5,238	184,573	—	5,238	184,573	—

Note 34: Financial risk management (continued)

As at 31 December 2021, the Sterling LIBOR balances in the above table relate to contracts that have not converted to a risk-free rate. The balance includes both contracts that mature in 2022 with further LIBOR interest rate fixings in the period and contracts where the counterparty has not yet agreed to fallback provisions that would have effect when LIBOR ceases. In both cases, these contracts will have both cash flows and valuations determined on a 'synthetic' LIBOR basis for reporting periods during 2022, unless they are transitioned to alternative benchmark rates.

In respect of the Group's hedge accounting relationships, for the purposes of determining whether:

– A forecast transaction is highly probable
– Hedged future cash flows are expected to occur
– A hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk
– An accounting hedging relationship should be discontinued because of a failure of the retrospective effectiveness test

the Group assumes that the interest rate benchmark on which the hedged risk or the cash flows of the hedged item or hedging instrument are based is not altered by uncertainties resulting from interest rate benchmark reform. In addition, for a fair value hedge of a non-contractually specified benchmark portion of interest rate risk, the Group assesses only at inception of the hedge relationship and not on an ongoing basis that the risk is separately identifiable and hedge effectiveness can be measured. The Group's most significant hedge accounting relationships are exposed to the following interest rate benchmarks: Sterling LIBOR, US Dollar LIBOR and EURIBOR.

At 31 December 2021, the Group expects that EURIBOR will continue to exist as a benchmark rate for the foreseeable future. Accordingly, the Group does not consider its fair value or cash flow hedges of the EURIBOR benchmark interest rate to be directly affected by interest rate benchmark reform and as a result does not anticipate changing the hedged risk to a different benchmark.

The notional amount of the hedged items that the Group has designated into cash flow hedge relationships that is directly affected by the interest rate benchmark reform is £1,256 million (2020: £2,136 million), of which £nil (2020: £1,403 million) relates to Sterling LIBOR and £1,256 million (2020: £733 million) relates to USD LIBOR. These are principally loans and advances to customers.

The interest rate benchmark reforms also affect liabilities designated in fair value hedges with a notional amount of £2,093 million (2020: £3,167 million), of which £nil (2020: £1,100 million) is in respect of Sterling LIBOR and £2,093 million (2020: £2,067 million) relates to USD LIBOR. These fair value hedges principally relate to debt securities in issue. There are no fair value hedges of assets affected.

At 31 December 2021, the notional amount of the hedging instruments in hedging relationships to which these amendments apply was £3,358 million, of which £2,102 million relates to US Dollar LIBOR fair value hedges and £1,256 million relates to US Dollar LIBOR cash flow hedges. At 31 December 2020, the notional amount of the hedging instruments in hedging relationships to which these amendments apply was £12,342 million, of which £1,100 million relates to Sterling LIBOR fair value hedges and £8,433 million relates to Sterling LIBOR cash flow hedges.

(B) Foreign exchange risk

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are 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. The Group also manages foreign currency risk via cash flow hedge accounting, utilising currency swaps.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group's main overseas operations are in the USA, Europe and Singapore. Details of the Group's structural foreign currency exposures are as follows:

	2021		2020	
	US Dollar	**Other non-sterling**	US Dollar	Other non-sterling
The Group and the Bank	**£m**	**£m**	£m	£m
Exposure	**94**	**—**	74	—

(C) Credit spread risk

Credit spread risk arises primarily from:

(i) the Markets business;
(ii) the Credit Valuation Adjustment (CVA), Debt Valuation Adjustment (DVA) and Funding Valuation Adjustment (FVA) sensitivity to credit spreads;
(iii) fair value positions in the banking book; and
(iv) debt securities holdings in the liquid asset portfolio in management of liquidity.

Credit spread risks are measured primarily through scenario analysis and Value at Risk (VaR) measures, which are reported within the Board risk appetite framework on a monthly basis. Supplementary measures such as sensitivity and exposure limits are also applied where they provide greater insight into risk positions. The frequency of reporting supplementary risk measures varies from daily to monthly.

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 weekly 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 tables below analyse financial instrument liabilities of the Group and the Bank on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity categories based on the remaining period at the balance sheet date; balances with no fixed maturity

Note 34: Financial risk management (continued)

are included in the over 5 years category. Interest Rate Swaps are included in the up to one month 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 2021						
Deposits from banks	**44**	**222**	**757**	**2,809**	**—**	**3,832**
Customer deposits and repurchase agreements	**18,054**	**4,696**	**2,924**	**2,209**	**107**	**27,990**
Financial liabilities at fair value through profit or loss	**6,287**	**5,016**	**3,827**	**558**	**1,149**	**16,837**
Debt securities in issue	**201**	**2,013**	**7,991**	**5,317**	**1,228**	**16,750**
Lease liabilities	**—**	**3**	**9**	**26**	**23**	**61**
Subordinated liabilities	**—**	**—**	**—**	**558**	**126**	**684**
Total non-derivative financial liabilities	**24,586**	**11,950**	**15,508**	**11,477**	**2,633**	**66,154**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**36,605**	**29,692**	**28,006**	**28,000**	**15,452**	**137,755**
Gross settled derivatives – inflows	**(35,767)**	**(28,853)**	**(27,261)**	**(27,064)**	**(14,015)**	**(132,960)**
Gross settled derivatives – net flows	**838**	**839**	**745**	**936**	**1,437**	**4,795**
Net settled derivative liabilities	**9,404**	**—**	**—**	**—**	**—**	**9,404**
Total derivative financial liabilities	**10,242**	**839**	**745**	**936**	**1,437**	**14,199**
At 31 December 2020						
Deposits from banks	251	864	478	4,011	—	5,604
Customer deposits and repurchase agreements	15,258	3,788	3,021	2,507	933	25,507
Financial liabilities at fair value through profit or loss	3,829	7,033	4,828	458	402	16,550
Debt securities in issue	1,288	1,395	5,715	5,436	2,420	16,254
Lease liabilities	—	2	8	36	30	76
Subordinated liabilities	—	—	—	551	135	686
Total non-derivative financial liabilities	20,626	13,082	14,050	12,999	3,920	64,677
Derivative financial liabilities:						
Gross settled derivatives – outflows	40,793	31,915	28,034	34,784	11,653	147,179
Gross settled derivatives – inflows	(39,055)	(30,204)	(26,965)	(34,107)	(12,017)	(142,348)
Gross settled derivatives – net flows	1,738	1,711	1,069	677	(364)	4,831
Net settled derivative liabilities	11,437	—	—	—	—	11,437
Total derivative financial liabilities	13,175	1,711	1,069	677	(364)	16,268

Note 34: Financial risk management (continued)

The Bank	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 2021						
Deposits from banks	**44**	**222**	**757**	**2,809**	**—**	**3,832**
Customer deposits and repurchase agreements	**17,655**	**4,689**	**2,915**	**2,209**	**107**	**27,575**
Financial liabilities at fair value through profit or loss	**6,287**	**5,016**	**3,827**	**558**	**1,149**	**16,837**
Debt securities in issue	**201**	**2,013**	**7,991**	**5,317**	**1,228**	**16,750**
Lease liabilities	**—**	**2**	**7**	**22**	**18**	**49**
Subordinated liabilities	**—**	**—**	**—**	**558**	**126**	**684**
Total non-derivative financial liabilities	**24,187**	**11,942**	**15,497**	**11,473**	**2,628**	**65,727**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**36,605**	**29,692**	**28,006**	**28,000**	**15,452**	**137,755**
Gross settled derivatives – inflows	**(35,767)**	**(28,853)**	**(27,261)**	**(27,064)**	**(14,015)**	**(132,960)**
Gross settled derivatives – net flows	**838**	**839**	**745**	**936**	**1,437**	**4,795**
Net settled derivative liabilities	**9,404**	**—**	**—**	**—**	**—**	**9,404**
Total derivative financial liabilities	**10,242**	**839**	**745**	**936**	**1,437**	**14,199**
At 31 December 2020						
Deposits from banks	251	864	478	4,011	—	5,604
Customer deposits and repurchase agreements	14,844	3,778	3,010	2,506	933	25,071
Financial liabilities at fair value through profit or loss	3,829	7,033	4,828	458	402	16,550
Debt securities in issue	1,288	1,395	5,715	5,436	2,420	16,254
Lease liabilities	—	1	6	27	22	56
Subordinated liabilities	—	—	—	551	135	686
Total non-derivative financial liabilities	20,212	13,071	14,037	12,989	3,912	64,221
Derivative financial liabilities:						
Gross settled derivatives – outflows	40,793	31,915	28,034	34,784	11,653	147,179
Gross settled derivatives – inflows	(39,055)	(30,204)	(26,965)	(34,107)	(12,017)	(142,348)
Gross settled derivatives – net flows	1,738	1,711	1,069	677	(364)	4,831
Net settled derivative liabilities	11,437	—	—	—	—	11,437
Total derivative financial liabilities	13,175	1,711	1,069	677	(364)	16,268

Note 34: Financial risk management (continued)

The following tables set out the amounts and residual maturities of off-balance sheet contingent liabilities, commitments and guarantees.

The Group	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
At 31 December 2021					
Acceptances and endorsements	**170**	**—**	**—**	**—**	**170**
Other contingent liabilities	**183**	**52**	**—**	**—**	**235**
Total contingent liabilities	**353**	**52**	**—**	**—**	**405**
Lending commitments and guarantees	**8,881**	**4,492**	**1,742**	**76**	**15,191**
Other commitments	**—**	**—**	**—**	**—**	**—**
Total commitments and guarantees	**8,881**	**4,492**	**1,742**	**76**	**15,191**
Total contingents, commitments and guarantees	**9,234**	**4,544**	**1,742**	**76**	**15,596**
At 31 December 2020					
Acceptances and endorsements	57	—	—	—	57
Other contingent liabilities	125	3	2	—	130
Total contingent liabilities	182	3	2	—	187
Lending commitments and guarantees	7,518	4,807	1,957	250	14,532
Other commitments	2	1	—	—	3
Total commitments and guarantees	7,520	4,808	1,957	250	14,535
Total contingents, commitments and guarantees	7,702	4,811	1,959	250	14,722

The Bank	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
At 31 December 2021					
Acceptances and endorsements	**170**	**—**	**—**	**—**	**170**
Other contingent liabilities	**183**	**52**	**—**	**—**	**235**
Total contingent liabilities	**353**	**52**			**405**
Lending commitments and guarantees	**8,881**	**4,492**	**1,742**	**76**	**15,191**
Other commitments	**—**	**—**	**—**	**—**	**—**
Total commitments and guarantees	**8,881**	**4,492**	**1,742**	**76**	**15,191**
Total contingents, commitments and guarantees	**9,234**	**4,544**	**1,742**	**76**	**15,596**
At 31 December 2020					
Acceptances and endorsements	57	—	—	—	57
Other contingent liabilities	125	3	2	—	130
Total contingent liabilities	182	3	2	—	187
Lending commitments and guarantees	7,518	4,807	1,957	250	14,532
Other commitments	2	1	—	—	3
Total commitments and guarantees	7,520	4,808	1,957	250	14,535
Total contingents, commitments and guarantees	7,702	4,811	1,959	250	14,722

Note 35: Capital

Capital management

Capital is actively managed on an ongoing basis for both the Bank and its regulated subsidiaries. Regulatory capital ratios are considered a key part of the budgeting and planning processes and forecast ratios are reviewed by the LBCM ALCO and the Board. Target capital levels take account of current and future regulatory requirements, capacity for growth and to cover uncertainties. Capital policies and procedures are subject to regular review.

Under UK law, EU capital rules that existed on 31 December 2020 continue to apply to the Bank following the end of the transition period for the UK's withdrawal from the European Union, subject to the temporary transitional powers (TTP) granted to the PRA which extend until 31 March 2022. The Bank continues to therefore measure both its capital requirements and the amount of capital resources it holds to meet those requirements through applying the regulatory framework defined by the Capital Requirements Directive and Regulation (CRD IV), as amended by revisions to the Capital Requirements Directive implemented in December 2020 (CRD V) and by those provisions of the revised Capital Requirements Regulation (CRR II) that came into force in June 2019 and December 2020. The requirements are implemented in the UK by the PRA and supplemented through additional regulation under the PRA Rulebook and associated statements of policy, supervisory statements and other guidance.

The remaining provisions of CRR II will apply in the UK from 1 January 2022 and have been largely enacted via the PRA Rulebook.

The minimum amount of total capital required, under Pillar 1 of the regulatory capital framework, is set at 8 per cent of total risk-weighted assets. At least 4.5 per cent of risk-weighted assets are required to be covered by common equity tier 1 (CET1) capital and at least 6 per cent of risk-weighted assets are required to be covered by tier 1 capital. These minimum Pillar 1 capital requirements are supplemented by additional minimum capital requirements under Pillar 2A of the regulatory capital framework, the aggregate of which is referred to as the Bank's Total Capital Requirement (TCR).

Under Pillar 2A, additional minimum capital requirements are set through the issuance of a bank specific Individual Capital Requirement (ICR), which adjusts the Pillar 1 minimum capital requirement for those risks not covered or not fully covered under Pillar 1. A key input into the PRA's ICR 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). The Bank's nominal Pillar 2A capital requirement was the equivalent of around 4.6 per cent of risk-weighted assets as at 31 December 2021, of which the minimum amount to be met by CET1 capital was the equivalent of around 2.6 per cent of risk-weighted assets. During 2022, the PRA will revert to setting a variable amount for the Bank's Pillar 2A capital requirement (being a set percentage of risk-weighted assets), with fixed add-ons for certain risk types.

A range of additional bank specific regulatory capital buffers apply under CRD IV, which are required to be met with CET1 capital. These include a capital conservation buffer (2.5 per cent of risk-weighted assets) and a time-varying countercyclical capital buffer (CCyB) which is currently around 0 per cent of risk-weighted assets. In December 2021 the Bank of England's Financial Policy Committee announced that the UK CCyB rate will increase to 1 per cent in December 2022, with an expectation that it will increase to 2 per cent in Q2 2023 if the economy continues to recover broadly in line with the Bank of England's central projections and upon the assumption there is no significant change to the financial stability outlook. This would represent an equivalent increase in the Bank's CCyB to 0.5 per cent in December 2022 and 0.9 per cent in Q2 2023, based upon the position of the Bank at 31 December 2021.

The Bank applies the full extent of the IFRS 9 transitional arrangements for capital as set out under CRR Article 473a (as amended via the CRR 'Quick Fix' revisions published in June 2020). Specifically, the Bank has opted to apply both paragraphs 2 and 4 of CRR Article 473a (static and dynamic relief) and in addition to apply a 100 per cent risk weight to the consequential Standardised credit risk exposure add-back as permitted under paragraph 7a of the revisions. As at 31 December 2021 no relief has been recognised through CET1 capital (31 December 2020: £34 million).

Regulatory capital development

The regulatory framework within which the Bank operates continues to be developed at a global level through the Financial Stability Board (FSB) and BCBS and within the UK by the PRA and through directions from the Financial Policy Committee (FPC). The Bank continues to monitor these developments very closely, analysing potential capital impacts to ensure that, through organic capital generation and management actions, the Bank and its regulated subsidiaries continue to maintain a strong capital position that exceeds both minimum regulatory requirements and the Bank's risk appetite and is consistent with market expectations.

On 1 January 2022 the Bank implemented a new standardised approach for measuring counterparty credit risk (SA-CCR) as part of the implementation of the remainder of CRR II.

Capital resources

Regulatory capital is divided into tiers depending on the degree of permanency and loss absorbency exhibited.

– 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 adjustments for IFRS 9 transitional arrangements, the elimination of the cash flow hedging reserve, the prudent valuation adjustment, the debit valuation adjustment and the accrual for foreseeable dividends.
– Fully qualifying additional tier 1 (AT1) capital comprises non-cumulative perpetual securities containing specific provisions to write down the security should the CET1 ratio fall to a defined trigger limit.
– 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 through the application of regulatory amortisation.

The Bank's capital resources are summarised as follows:

	2021 **£m**	2020 £m
Common equity tier 1 capital	**2,423**	2,462
Additional tier 1 capital	**757**	757
Tier 2 capital	**529**	526
Total capital	**3,709**	3,745

Note 36: Cash flow statements

(A) Change in operating assets

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Change in amounts due from fellow Lloyds Banking Group undertakings	**561**	(408)	**356**	(399)
Change in other financial assets held at amortised cost[1]	**(2,996)**	1,301	**(3,003)**	1,287
Change in financial assets at fair value through profit or loss[1]	**(1,481)**	(2,786)	**(1,427)**	(2,785)
Change in derivative financial instruments	**3,598**	(2,828)	**3,607**	(2,833)
Change in other operating assets	**646**	(938)	**647**	(942)
Change in operating assets	**328**	(5,659)	**180**	(5,672)

1 Restated - See note 1

(B) Change in operating liabilities

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Change in deposits from banks	**(1,781)**	1,634	**(1,781)**	1,634
Change in customer deposits and repurchase agreements	**2,468**	1,069	**2,490**	1,102
Change in amounts due to fellow Lloyds Banking Group undertakings	**159**	1,645	**261**	1,575
Change in financial liabilities at fair value through profit or loss	**767**	2,031	**767**	2,031
Change in derivative financial instruments	**(5,661)**	3,471	**(5,662)**	3,471
Change in debt securities in issue	**967**	3,289	**967**	3,288
Change in other operating liabilities[1,2]	**(548)**	432	**(544)**	436
Change in operating liabilities	**(3,629)**	13,571	**(3,502)**	13,537

1 Includes a decrease of £(13) million (2020: increase of £6 million) for the Group and a decrease of £(13) million (2020: decrease of £7 million) for the Bank in respect of lease liabilities.
2 Restated - See note 1

(C) Non-cash and other items

	The Group		The Bank	
	2021	2020[2]	**2021**	2020[2]
	£m	£m	**£m**	£m
Depreciation and amortisation	**15**	16	**10**	13
Impairment of investment in subsidiaries	**—**	—	**20**	72
Dividends received from subsidiary undertakings	**—**	—	**(44)**	(57)
Allowance for loan losses (net of recoveries)	**(37)**	35	**(37)**	34
Impairment charge/(credit) relating to undrawn balances	**(25)**	36	**(25)**	36
Unwind of discount on impairment allowances	**—**	(1)	**—**	(1)
Other provision movements	**4**	2	**2**	1
Foreign exchange impact on balance sheet[1]	**(54)**	84	**(52)**	81
Other non-cash items	**(28)**	(1)	**(26)**	(2)
Non-cash and other items	**(125)**	171	**(152)**	177

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.
2 Restated - See note 1

(D) Analysis of cash and cash equivalents as shown in the balance sheet

	The Group		The Bank	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Cash and balances at central banks	**22,140**	23,369	**22,140**	23,369
Less mandatory reserve deposits[1]	**(215)**	(160)	**(215)**	(160)
	21,925	23,209	**21,925**	23,209
Loans and advances to banks and reverse repurchase agreements	**2,890**	5,260	**2,869**	5,231
Less amounts with a maturity of three months or more	**(1,757)**	(2,099)	**(1,756)**	(2,099)
	1,133	3,161	**1,113**	3,132
Total cash and cash equivalents	**23,058**	26,370	**23,038**	26,341

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.

Note 37: Events since the balance sheet date

In February 2022 the Group announced that the Singapore Branch would be closing during 2022. The estimated costs associated with this closure are in the process of being quantified.

Note 38: Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2021 and have not been applied in preparing these financial statements.

With the exception of certain minor amendments, as at 24 March 2022 these pronouncements have been endorsed for use in the United Kingdom.

Minor amendments to other accounting standards
The IASB has issued a number of minor amendments to IFRSs effective 1 January 2021 and in later years (including IFRS 9 *Financial Instruments* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*). These amendments are not expected to have a significant impact on the Group.

Note 39: Other information

Lloyds Bank Corporate Markets plc is incorporated as a public limited company and registered in England with the registered number 10399850. Lloyds Bank Corporate Markets plc's registered office is 25 Gresham Street, London, EC2V 7HN, and its principal executive offices are located at 10 Gresham Street, London, EC2V 7AE.

Lloyds Bank Corporate Markets 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 overseas.

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

Subsidiaries and related undertakings

In compliance with Section 409 of the Companies Act 2006, the following comprises a list of all related undertakings of the Group, as at 31 December 2021. The list includes each undertaking's registered office and the percentage of the class(es) of shares held by the Group. All shares held are ordinary shares unless indicated otherwise in the notes.

The Bank directly or indirectly holds 100 per cent of the share class and a majority of voting rights in the following undertakings.

Subsidiary undertaking	Bank interest	Registered office address
Black Horse Offshore Limited	100.00%	9 Broad Street, St Helier, Jersey, JE2 3RR
Lloyds America Securities Corporation	100.00%[1]	The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801
Lloyds Bank (International Services) Limited	100.00%	9 Broad Street, St Helier, Jersey, JE2 3RR
Lloyds Bank Corporate Asset Finance (No.1) Limited	100.00%	25 Gresham Street, London EC2V 7HN
Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH	100.00%	Thurn-Und, Frankfurt Am Main, 60313, Germany
Lloyds International Management Services (Jersey) Limited (formerly Lloyds Bank International Limited)	100.00%	9 Broad Street, St Helier, Jersey, JE2 3RR
Lloyds Corporate Services (Jersey) Limited	100.00%	9 Broad Street, St Helier, Jersey, JE2 3RR
Lloyds Holdings (Jersey) Limited	100.00%	9 Broad Street, St Helier, Jersey, JE2 3RR
Lloyds Securities Inc.	100.00%[2]	The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801
Nominees (Jersey) Limited	100.00%	9 Broad Street, St Helier, Jersey, JE2 3RR

1 10,000 US$ No par value

2 10 US$ 0.1% common