Lloyds Bank plc

Report and Accounts
2017

Member of Lloyds Banking Group

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Strategic report

Principal activities

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

The Group's revenue is earned through interest and fees on a broad range of financial services products including current and savings accounts, personal loans, credit cards and mortgages within the retail market; loans and capital market products to commercial, corporate and asset finance customers; life, pensions and investment products; general insurance; and private banking and asset management.

Business review

As a result of the requirements of the ring-fencing regulations, the Bank expects to sell its subsidiary, Scottish Widows Group Limited, to its ultimate holding company during 2018. At the time of preparation of the 2016 report and accounts this sale had been expected to take place during 2017, however due to external factors the Group currently expects the transaction to complete in 2018. This is only an internal reorganisation within the Lloyds Banking Group, but due to the significance of the Scottish Widows entities they have been classified as discontinued operations for the purposes of the Bank's consolidated statutory reporting.

Continuing operations

During the year ended 31 December 2017, the Group recorded a profit before tax from its continuing operations of £5,035 million compared with a profit before tax in 2016 of £1,977 million. The results in 2016 were particularly impacted by a loss of £993 million arising on transactions related to Lloyds Banking Group's tender offers and redemptions in respect of its Enhanced Capital Notes which completed in March 2016 and a loss of £1,026 million which arose pursuant to a restructuring of the Bank's capital instruments in June 2016. Excluding these items from the comparative, the Group's continuing operations recorded a profit before tax of £5,035 million in 2017, which was £1,039 million, or 26 per cent, higher than the profit before tax in 2016 of £3,996 million.

Total income increased by £2,872 million, or 20 per cent, to £17,352 million in 2017 compared with £14,480 million in 2016, comprising a £1,170 million increase in net interest income together with an increase of £1,702 million in other income.

Net interest income was £12,364 million in 2017; an increase of £1,170 million, or 10 per cent compared to £11,194 million in 2016. Average interest-earning assets fell as a result of decreases in average UK mortgage balances, lending to global corporates and in the portfolio of assets which are outside of the Group's risk appetite, more than offsetting the impact of the acquisition of MBNA. However, this was more than offset by the impact of an improvement in net interest margin as a result of lower deposit and wholesale funding costs and a positive impact from the acquisition of MBNA, more than offsetting continued pressure on asset margins.

Other income was £1,702 million, or 52 per cent, higher at £4,988 million in 2017 compared to £3,286 million in 2016, reflecting the liability management losses of £2,019 million in 2016 discussed above. Fee and commission income was £58 million, or 2 per cent, lower at £2,786 million compared to £2,844 million in 2016 as increased levels of card fees, reflecting both the acquisition of MBNA and higher levels of card usage, were more than offset by lower current account fees, reflecting reduced volumes of added-value accounts and changes in pricing structure, and lower levels of other fees receivable. Fee and commission expense increased by £81 million, or 9 per cent, to £1,024 million compared with £943 million in 2016. Net trading income decreased by £169 million, or 18 per cent, to £773 million in 2017 compared to £942 million in 2016; this decrease reflected the change in fair value of interest rate derivatives and foreign exchange hedges in the banking book not mitigated through hedge accounting.

Other operating income was £2,010 million higher at £2,453 million in 2017 compared to £443 million in 2016 , as a result of the liability management losses of £2,019 million in 2016 discussed above.

Operating expenses decreased by £121 million, or 1 per cent to £11,630 million in 2017 compared with £11,751 million in 2016; reflecting the £149 million reduction in charges for redress payments to customers in respect of PPI and other conduct related matters from £2,271 million in 2016 to £2,122 million in 2017 (for further details on these charges see note 32 to the financial statements). Excluding these charges from both years, operating expenses were £28 million higher at £9,508 million in 2017 compared to £9,480 million in 2016 as operating expenses of £172 million arising in MBNA since acquisition have been largely offset by the impact of underlying cost reductions. Staff costs were £210 million, or 5 per cent, lower at £4,418 million in 2017 compared with £4,628 million in 2016; increases in pension charges were more than offset by headcount related reductions in salaries and lower levels of severance costs. Premises and equipment costs were £23 million or 3 per cent, higher at £690 million in 2017 compared with £667 million in 2016. Other expenses were £215 million, or 11 per cent, higher at £2,100 million in 2017 compared with £1,885 million in 2016. Depreciation and amortisation costs were £8 million lower at £2,292 million in 2017 compared to £2,300 million in 2016, as increased charges in respect of property, plant and equipment were more than offset by reduced charges relating to intangible assets, reflecting the fact that the core deposit intangible arising from the HBOS acquisition became fully amortised in the early part of 2017.

Impairment losses decreased by £65 million, or 9 per cent, to £687 million in 2017 compared with £752 million in 2016; this reflects the fact that in 2016 there was an impairment charge of £173 million in respect of certain equity investments in the Group's available-for-sale portfolio which was not repeated in 2017. Impairment losses in respect of loans and advances to customers were £104 million, or 18 per cent, higher at £696 million in 2017 compared with £592 million in 2016; this includes a charge of £118 million in the MBNA business since acquisition and there were lower levels of releases and write-backs than in 2016. There was a credit of £9 million in respect of undrawn commitments in 2017, compared to a credit of £13 million in 2016.

In 2017, the Group's continuing operations recorded a tax expense of £1,602 million compared to a tax expense of £947 million in 2016, an effective tax rate of 32 per cent, compared to the standard UK corporation tax rate of 19.25 per cent, principally as a result of the banking surcharge and restrictions on the deductibility of conduct provisions.

Discontinued operations

During the year ended 31 December 2017, the Group's discontinued operations recorded a profit before tax of £943 million compared with a profit before tax in 2016 of £579 million.

Total income decreased by £6,534 million, or 27 per cent, to £17,516 million in 2017 compared with £24,050 million in 2016, comprising a £7,368 million decrease in other income only partly offset by an improvement of £834 million in net interest income.

Net interest income was a deficit of £1,313 million in 2017; an improvement of £834 million compared to a deficit of £2,147 million in 2016, reflecting a positive impact of £622 million in 2017 from a decrease in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group, reflecting different levels of investment returns on the assets held by the OEICs.

Other income was £7,368 million, or 28 per cent, lower at £18,829 million in 2017 compared to £26,197 million in 2016. Fee and commission income was £92 million lower at £373 million compared to £465 million in 2016 and fee and commission expense decreased by £123 million to £553 million compared with £676 million in 2016, together leading to an improvement of £31 million in net fee and commission income from a deficit of £211 million in 2016 to a deficit of £180 million in 2017. Net trading income decreased by £6,613 million, or 38 per cent, to £10,977 million in 2017 compared to £17,590 million in 2016; this decrease reflected a reduction in gains on policyholder investments as a result of market conditions over 2017 relative to those in 2016. Insurance premium income was £138 million, or 2 per cent, lower at £7,930 million in 2017 compared with £8,068 million in 2016; there was a decrease of £23 million in life insurance premiums and a £115 million decrease in general insurance premiums. The decrease in life insurance premiums reflects the fact that good growth in corporate pensions business has been offset by a lower level of bulk annuity deals, compared to the activity in 2016. General insurance premiums decreased as a result of market conditions and the continued run-off of closed books. Other operating income was £648 million lower at £102 million in 2017 compared to £750 million in 2016 as a result of a reduction of £637 million in the movement in value of in-force business from a gain of £472 million in the year ended 31 December 2016 to a charge of £165 million in 2017, which reflected the negative impact of assumption changes and experience variances.

Insurance claims expense was £6,766 million, or 30 per cent, lower at £15,578 million in 2017 compared to £22,344 million in 2016. The insurance claims expense in respect of life and pensions business was £6,737 million lower at £15,241 million in 2017 compared to £21,978 million in 2016; this decrease was matched by a similar reduction in net trading income, reflecting the relative performance of policyholder investments. Insurance claims in respect of general insurance business were £29 million or 8 per cent, lower at £337 million in 2017 compared to £366 million in 2016 as a result of the continued run-down of closed books and relatively benign weather conditions in 2017 compared to 2016.

Operating expenses decreased by £132 million, or 12 per cent to £995 million in 2017 compared with £1,127 million in 2016; the decrease being partly due to the £60 million reduction in charges for redress payments to customers in respect of conduct related matters from £103 million in 2016 to £43 million in 2017. Excluding these charges from both years, operating expenses were £72 million, or 7 per cent, lower at £952 million in 2017 compared to £1,024 million in 2016 as a result of underlying cost reductions.

In 2017, the Group's discontinued operations recorded a tax expense of £147 million compared to a tax expense of £406 million in 2016; the charge in 2016 included a £231 million write down of the deferred tax asset held within the life business, reflecting the Group's utilisation estimate which was restricted by the economic environment.

Balance sheet and capital
Total assets were £7,897 million, or 1 per cent, lower at £823,030 million at 31 December 2017 compared to £830,927 million at 31 December 2016. Derivative assets were £9,707 million, or 29 per cent, lower at £24,152 million at 31 December 2017 compared to £33,859 million at 31 December 2016, largely as a result of exchange rate movements. Loans and advances to customers were £14,273 million, or 3 per cent, higher at £465,555 million at 31 December 2017 compared to £451,282 million at 31 December 2016; the addition of £8,144 million of lending following the acquisition of MBNA and an £8,528 million increase in reverse repurchase agreement balances together with the impact of the reacquisition of a portfolio of mortgages from TSB and growth in consumer finance and SME lending have more than offset reductions in the larger corporate sector, as the Group focuses on optimising capital and returns, and in closed mortgage books. Available-for-sale financial assets were £14,807 million, or 26 per cent, lower at £41,717 million at 31 December 2017 compared to £56,524 million at 31 December 2016 reflecting reductions in the Group's holdings of UK government securities.

Total liabilities were £8,840 million, or 1 per cent, lower at £771,836 million at 31 December 2017 compared to £780,676 million at 31 December 2016. Deposits from banks were £13,198 million, or 84 per cent, higher at £28,888 million at 31 December 2017 compared to £15,690 million at 31 December 2016 as a result of an increase of £15,896 million in repurchase agreements, used as a favourable form of funding. Customer deposits were £2,664 million, or 1 per cent, higher at £418,124 million compared to £415,460 million at 31 December 2016 as reductions in non-relationship deposit balances were more than offset by strong inflows from Commercial clients. Derivative liabilities were £9,197 million, or 27 per cent, lower at £24,699 million at 31 December 2017 compared to £33,896 million at 31 December 2016, largely as a result of exchange rate movements. Debt securities in issue were £12,868 million, or 17 per cent, lower at £61,865 million at 31 December 2017 compared to £74,733 million at 31 December 2016 following maturities of some tranches of medium-term notes, securitisation notes and covered bonds. Subordinated liabilities were £2,476 million, or 14 per cent, lower at £14,782 million at 31 December 2017 compared to £17,258 million at 31 December 2016 reflecting redemptions in the year.

Total equity was £943 million, or 2 per cent, higher at £51,194 million at 31 December 2017 compared to £50,251 million at 31 December 2016 as retained profits for the year have more than offset the Group's dividend payments, distributions on its AT1 securities and other reserve movements.

The Group's common equity tier 1 capital ratio increased to 15.8 per cent (31 December 2016: 15.1 per cent), reflecting a combination of profit generation, the receipt of dividends paid by the Insurance business during the year and a reduction in the deferred tax asset deducted from capital, partially offset by the accrual for foreseeable dividends in respect of 2017 earnings, movements in the defined benefit pension schemes and an increase in the deduction for goodwill and other intangible assets, largely in relation to the acquisition of MBNA. The tier 1 capital ratio increased to 18.3 per cent (31 December 2016: 17.7 per cent) primarily reflecting the reduction in risk-weighted assets, partially offset by the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments. The total capital ratio increased to 21.5 per cent (31 December 2016: 21.2 per cent), largely reflecting the reduction in risk-weighted assets and significant investments, partially offset by amortisation and foreign exchange movements on tier 2 instruments.

Risk-weighted assets reduced by £10,155 million, or 4.7 per cent, to £206,028 million at 31 December 2017, compared to £216,183 million at 31 December 2016, largely reflecting the internal transfer of the private equity investment business and other equity portfolios to the new equity investment group under the parent company (Lloyds Banking Group plc) as part of ring-fencing related restructuring activities, updates made to both mortgage and unsecured retail IRB models, continued active portfolio management, foreign exchange movements, disposals and capital efficient securitisation activity, partly offset by the acquisition of MBNA and targeted growth in key customer segments.

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

Over the course of 2018, in order to comply with the ring-fencing legislation, certain businesses will be transferred out of Lloyds Bank plc and its subsidiaries to other parts of the Lloyds Banking Group, by means of statutory or other transfers. This will include the transfer of certain wholesale and international businesses to Lloyds Bank Corporate Markets plc. A number of actions are required to occur before these businesses can be transferred.

Capital position at 31 December 2017
The Group's capital position applying CRD IV transitional rules as at 31 December 2017 is set out in the following section.

Table 1.1: Capital resources

Capital resources (audited)	2017 £m	2016 £m
Common equity tier 1		
Shareholders' equity per balance sheet	**47,598**	46,289
Adjustment to retained earnings for foreseeable dividends	**(2,475)**	(1,568)
Deconsolidation adjustments[1]	**738**	911
Adjustment for own credit	**109**	87
Cash flow hedging reserve	**(1,573)**	(2,224)
Other adjustments	**(28)**	(90)
	44,369	43,405
Less: deductions from common equity tier 1		
Goodwill and other intangible assets	**(2,952)**	(1,623)
Prudent valuation adjustment	**(454)**	(630)
Excess of expected losses over impairment provisions and value adjustments	**(477)**	(602)
Removal of defined benefit pension surplus	**(541)**	(267)
Securitisation deductions	**(191)**	(217)
Significant investments[1]	**(3,990)**	(3,986)
Deferred tax assets	**(3,264)**	(3,536)
Common equity tier 1 capital	**32,500**	32,544
Additional tier 1		
Additional tier 1 instruments	**6,593**	7,061
Less: deductions from tier 1		
Significant investments[1]	**(1,373)**	(1,329)
Total tier 1 capital	**37,720**	38,276
Tier 2		
Tier 2 instruments	**7,700**	8,920
Eligible provisions	**120**	186
Less: deductions from tier 2		
Significant investments[1]	**(1,241)**	(1,571)
Total tier 2 capital	**6,579**	7,535
Total capital resources	**44,299**	45,811
Risk-weighted assets	**206,028**	216,183
Common equity tier 1 capital ratio	**15.8%**	15.1%
Tier 1 capital ratio	**18.3%**	17.7%
Total capital ratio	**21.5%**	21.2%

[1] For regulatory capital purposes the Group's Insurance business is deconsolidated and replaced by the amount of the Group's investment in the business. A part of this amount is deducted from capital (shown as 'significant investments' in the table above) and the remaining amount is risk-weighted, forming part of threshold risk-weighted assets.

Table 1.2: Risk-weighted assets (unaudited)

	2017 £m	2016 £m
Risk-weighted assets		
Foundation Internal Ratings Based (IRB) Approach	**60,207**	64,907
Retail IRB Approach	**61,588**	64,970
Other IRB Approach	**12,359**	17,788
IRB Approach	**134,154**	147,665
Standardised Approach	**25,283**	18,956
Credit risk	**159,437**	166,621
Counterparty credit risk	**6,055**	8,419
Contributions to the default fund of a central counterparty	**428**	340
Credit valuation adjustment risk	**1,402**	864
Operational risk	**24,880**	25,292
Market risk	**3,051**	3,147
Underlying risk-weighted assets	**195,253**	204,683
Threshold risk-weighted assets	**10,775**	11,500
Total risk-weighted assets	**206,028**	216,183

Principal risks and uncertainties
The most significant risks faced by the Group which could impact the delivery of our long-term strategic objectives and our approach to each risk, are detailed below.

As part of Lloyds Banking Group's ongoing assessment of the potential implications of the UK leaving the European Union, Lloyds Banking Group continues to consider the impact to its customers, colleagues and products – as well as legal, regulatory, tax, financial and capital implications. There remains continued uncertainty around both the UK and global political and macroeconomic environment. The potential impacts of external factors have been considered in all principal risks to ensure any material uncertainties continue to be monitored and are appropriately mitigated.

This year we have added a new principal risk, model risk, to reflect Lloyds Banking Group's increasing use of analytics and models to make decisions.

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

Key mitigating actions
- Credit policy, incorporating prudent lending criteria, aligned with Lloyds Banking Group Board approved risk appetite, to effectively manage risk.
- Robust risk assessment and credit sanctioning to ensure we lend appropriately and responsibly.
- Extensive and thorough credit processes and controls to ensure effective risk identification, management and oversight.
- Effective, well-established governance process supported by independent credit risk assurance.
- Early identification of signs of stress leading to prompt action in engaging the customer.

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

Key mitigating actions
- Ensure Lloyds Banking Group develops comprehensive plans for delivery of all legal and regulatory changes and track their progress. Lloyds Banking Group, Group-wide projects implemented to address significant impacts.
- Continued investment in people, processes, training and IT to assess impact and help meet our legal and regulatory commitments.
- Engage with regulatory authorities and industry bodies on forthcoming regulatory changes, market reviews and investigations.

Conduct risk – Conduct risk can arise from a number of areas including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; failing to promote effective competition in the interest of customers; and exhibiting behaviours which could impact on the integrity of the market or undermine wider regulatory standards.

Key mitigating actions
- Conduct risk appetite metrics provide a granular view of how our products and services are performing for customers.
- Product approval, continuous product review processes and customer outcome testing (across products and services) supported by conduct management information.
- Learning from past mistakes through root cause analysis and clear customer accountabilities for colleagues, with rewards driven by customer-centric metrics.
- Further enhancements and embedding of our framework to support customers in vulnerable circumstances.

Operational risk – We face significant operational risks which may disrupt services to customers, cause reputational damage, and result in financial loss. These include the availability, resilience and security of our core IT systems, unlawful or inappropriate use of customer data, theft of sensitive data, fraud and financial crime threats, and the potential for failings in our customer processes.

Key mitigating actions
- Investing in enhanced cyber controls to protect against external threats to the confidentiality or integrity of electronic data, or the availability of systems, and to ensure effective third party assurance.
- Enhancing the resilience of systems that support critical business processes with independent verification of progress on an annual basis.
- Significant investment in compliance with General Data Protection Regulation and Basel Committee on Banking Supervision standards.
- Working with industry bodies and law enforcement agencies to identify and combat fraud and money laundering.

People risk – Key people risks include the risk that we fail to maintain organisational skills, capability, resilience and capacity levels in response to organisational, political and external market change and evolving business needs.

Key mitigating actions
- Focused action to attract, retain and develop high calibre people. Delivering initiatives which reinforce behaviours to generate the best outcomes for customers and colleagues.
- Managing organisational capability and capacity to ensure there are the right skills and resources to meet our customers' needs.
- Effective remuneration arrangements to promote appropriate colleague behaviours and meet regulatory expectations.

Insurance underwriting risk – Key insurance underwriting risks within the Insurance business are longevity, persistency and property insurance. Longevity risk is expected to increase as our presence in the bulk annuity market increases.

Key mitigating actions
- Processes for underwriting, claims management, pricing and product design seek to control exposure. Longevity and bulk pricing experts support the bulk annuity proposition.
- The merits of longevity risk transfer and hedging solutions are regularly reviewed for the Insurance business.
- Property insurance exposures are mitigated by a broad reinsurance programme.

Capital risk – The risk that we have 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 we meet regulatory requirements and risk appetite.
- Comprehensive stress testing analyses to evidence capital adequacy under various adverse scenarios.

Funding and liquidity risk – The risk that we have insufficient financial resources to meet our commitments as they fall due.

Key mitigating actions
- Holding liquid assets to cover potential cash and collateral outflows and to meet regulatory requirements. In addition, maintaining a further pool of assets that can be used to access central bank liquidity facilities.
- Undertaking daily monitoring against a number of market and Lloyds Banking Group specific early warning indicators.
- Maintaining a contingency funding plan detailing actions and strategies available in stressed conditions.

Governance risk – Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from meeting the requirements to ring-fence core UK financial services and activities from January 2019 and further requirements under the Senior Manager & Certification Regime (SM&CR).

Key mitigating actions
- Leveraging our considerable change experience to meet ring-fencing requirements before the regulatory deadlines, and the continuing evolution of SM&CR.
- Programme in place to address ring-fencing. In close and regular contact with regulators to develop and deploy our planned operating and legal structure.
- Evolving risk and governance arrangements to continue to be appropriate to comply with regulatory objectives.

Market risk – The risk that our capital or earnings profile is affected by adverse market rates, in particular interest rates and credit spreads in the banking business, equity and credit spreads in the Insurance business, and credit spreads in the Group's defined benefit (DB) pension schemes.

Key mitigating actions
- Structural hedge programmes implemented to manage liability margins and margin compression.
- Equity and credit spread risks are closely monitored and, where appropriate, asset and liability matching is undertaken.
- The Group's DB pension schemes have increased their credit allocation and hedged against nominal rate and inflation movements.

Model risk – The risk of financial loss, regulatory censure, reputational damage or customer detriment, as a result of deficiencies in the development, application and ongoing operation of financial models and rating systems.

Key mitigating actions
A comprehensive model risk management framework including:

- Defined roles and responsibilities, with clear ownership and accountability.
- Principles regarding the requirements of data integrity, development, validation, implementation and ongoing maintenance.
- Regular model monitoring.
- Independent review of models.
- Periodic validation and re-approval of models.

Financial risk management objectives and policies
Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in note 43 on page 99. 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 2017 Strategic Report has been approved by the Board of Directors.

On behalf of the Board

Lord Blackwell
Lloyds Bank plc
13 March 2018

Directors' report

Results
The consolidated income statement on page 21 shows a statutory profit before tax from continuing operations for the year ended 31 December 2017 of £5,035 million (year ended 31 December 2016: £1,977 million).

Dividends
During the year the Bank paid interim dividends of £1,600 million and £1,050 million, a cumulative total of £2,650 million (2016: £3,040 million). The Directors have not recommended a final dividend for the year ended 31 December 2017 (2016: nil). In February 2018, the Directors approved the payment of a further interim dividend of £7,622 million, subject to the planned sale of Scottish Widows Group Limited to the Bank's parent, Lloyds Banking Group plc, to be effected as part of the Group's ring-fencing planning, happening concurrently. The timing for the payment of this dividend and the sale of Scottish Widows Group Limited is subject to certain conditions.

Post balance sheet events
There have been no material post-balance sheet events save for the further interim dividend of £7,622 million referred to above.

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 considered the principal risks and uncertainties and capital position set out in the strategic report on pages 2 to 6 and additionally have considered projections for the Bank's and the Group's capital and funding position. 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 appoval of the financial statements and therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Directors
The names of the current Directors are shown on page 10. Changes to the composition of the Board since 1 January 2017 up to the date of this report are shown in the table below:

	Joined the Board	Retired from the Board
Nicholas Luff		10 May 2017
Anthony Watson		11 May 2017
Lord Lupton	1 June 2017	

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' indemnities
The Directors of the Bank, including the former Directors who retired during the year, have entered into individual deeds of indemnity with Lloyds Banking Group plc which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the Director appointed in 2017. In addition, Lloyds Banking Group plc had appropriate Directors' and Officers' liability insurance cover in place throughout 2017. Deeds for existing Directors are available for inspection at the Bank's registered office.

Lloyds Banking Group plc has also granted deeds of indemnity by deed poll and by way of entering into individual deeds, which constitute 'qualifying third party indemnity provisions' to the Directors of the Group's subsidiary companies, including to former Directors who retired during the year and since the year end. Such deeds were in force during the financial year ended 31 December 2017 and remain in force as at the date of this report. Qualifying pension scheme indemnities have also been granted to the Trustees of Lloyds Banking Group's Pension Schemes, which were in force for the whole of the financial year and remain in force as at the date of this report.

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

Conflicts of interest
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 interests. Directors have a duty to notify the Chairman and Company Secretary as soon as they become aware of actual or potential conflict situations. Changes to 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.

Stuart Sinclair is Senior Independent Director at both QBE Insurance (Europe) Limited, a general insurance and reinsurance company. Lord Lupton is a senior advisor to Greenhill Europe, an investment bank focused on providing financial advice on significant mergers, acquisitions, restructurings, financings and capital raising to corporations, partnerships, institutions and governments. The Board has recognised that potential conflicts may arise as a result of these positions. The Board has authorised the potential conflicts and requires Mr Sinclair and Lord Lupton to recuse themselves from discussions, should the need arise.

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

Share capital
Information about share capital is shown in note 34 on page 88. This information is incorporated into this report by reference.

The Bank did not repurchase any of its shares during 2017 (2016: none). 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.

Directors' report

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.

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

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

Employees
Lloyds Banking Group (the 'Group'), of which the Bank is a part, continues to promote inclusion and diversity ('I&D') through its Group Executive Committee. Several senior Group executives are I&D sponsors, and an Operational Committee oversees how I&D plans are implemented. During 2017, the Group continued to make good progress against its I&D strategy. The proportion of colleagues who agree that the Group is an inclusive place to work increased to 89 per cent, 3 per cent more than in 2016, and almost half of Group colleagues are members or supporters of one of its five diversity networks. The Group has committed to ensure that women hold 40 per cent of its senior roles by 2020, and to help reach this target it monitors gender diversity on candidate lists for senior appointments. Over 400 women have now completed its Women in Leadership programme, with 100 achieving promotion. The Group continued to develop and promote its Authentic Leadership Programme for Black, Asian and Minority Ethnic leaders, fostering cultural awareness through promoting role models and communication campaigns. The Group met its target to increase the engagement levels of Black, Asian and Minority Ethnic colleagues, colleagues with disabilities and Lesbian, Gay and Bisexual colleagues above 70 per cent, three years earlier than its target date of 2020.

This year, the Department for Work and Pensions designated Lloyds Banking Group as a Disability Confident Leader for its inclusive recruitment process and in November, Lloyds Banking Group won a 'Nothing about us without us' Disability Smart Award, recognising the way insights about disability are gathered from colleagues, customers and charities, then used to inform decisions. As a member of the Business Disability Forum, Lloyds Banking Group is proud to have retained Gold accreditation in the Disability Standard. The Group's colleague disability network, Access, ran a successful national event, while more than 2,300 colleagues completed our industry leading workplace adjustment process. The Group offers bespoke development programmes and recruitment processes for colleagues and job applicants with disabilities, aiming to appoint the best candidate into any role and give full and fair consideration to job applications from those with disabilities, and the Group is unbiased in the way it assesses, selects, appoints, trains and promotes people. The Group offers a guaranteed interview scheme for candidates who declare a disability and meet the minimum requirements of the role, and continues to run a Disability Work Experience Programme in partnership with Remploy. This is one of the largest disability-focused work experience initiatives in the financial services sector; the Group has increased its number of candidates from 96 in 2016 to 392 in 2017.

The Group regularly and systematically updates colleagues on its performance and changes in the economic and regulatory environment including matters that concern their role. The Group also encourages colleagues to share their ideas and views to help shape the Group's future, including through its 'Best Bank for Customers' and 'Building the Best Team' surveys that are run by an independent third party every year.

The Group offers a competitive and fair reward package that supports its aims as a responsible business – with customer-facing colleagues in its Retail division incentivised on the basis of actions and behaviours that put customers first. The Group offers colleague share schemes to encourage shared ownership of the Group.

Significant contracts
Details of related party transactions are set out in note 41 on pages 93 to 96.

Statement of directors' responsibilities
The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and the Group and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the financial statements is placed on the website www.lloydsbankinggroup.com. The Directors are responsible for the maintenance and integrity in relation to the 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 are shown on page 10 of this annual report, confirms that, to the best of his or her knowledge:

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

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

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

A resolution will be proposed at the 2018 annual general meeting to re-appoint PricewaterhouseCoopers LLP as auditor. The Bank's Audit Committee is satisfied that the external auditor remains independent and effective.

On behalf of the Board

Malcolm Wood
Company Secretary
13 March 2018

Lloyds Bank plc
Registered in England & Wales
Company Number 2065

Directors

Lord Blackwell *Chairman*

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

George Culmer *Executive Director and Chief Financial Officer*

Juan Colombás *Executive Director and Chief Operating Officer*

Alan Dickinson

Anita Frew

Simon Henry

Lord Lupton CBE

Deborah McWhinney

Nick Prettejohn

Stuart Sinclair

Sara Weller CBE

Forward looking statements

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

Examples of such forward looking statements include, but are not limited to: projections or expectations of the Lloyds Bank 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 Lloyds Bank Group's future financial performance; the level and extent of future impairments and write-downs; statements of plans, objectives or goals of the Lloyds Bank Group or its management including in respect of statements about the future business and economic environments in the UK and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements made by the Lloyds Bank Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Lloyds Bank 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; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, instability as a result of the exit by the UK from the European Union (EU) and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Lloyds Bank Group's or Lloyds Banking Group plc's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; changes to regulatory capital or liquidity requirements and similar contingencies outside the Lloyds Bank Group's or Lloyds Banking Group plc's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation together with any resulting impact on the future structure of the Lloyds Bank Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; actions or omissions by the Lloyds Bank Group's directors, management or employees including industrial action; changes to the Lloyds Bank Group's post-retirement defined benefit scheme obligations; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Lloyds Bank Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission for a discussion of certain factors together with examples of forward looking statements.

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

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANK PLC

Report on the audit of the financial statements

Opinion

In our opinion, Lloyds Bank plc's Group financial statements and Bank financial statements (the "financial statements"):

– give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2017 and of the Group's profit and the Group's and the Bank's cash flows for the year then ended;
– have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards the Bank's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
– have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Report and Accounts (the "Annual Report"), which comprise: the balance sheets at 31 December 2017; the consolidated income statement and the statements of comprehensive income for the year then ended; the statements of changes in equity for the year then ended; and the cash flow statements for the year then ended; and the notes to the accounts, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Bank.

Other than those disclosed in note 9 to the financial statements, we have provided no non-audit services to the Group or the Bank in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview

– Overall Group materiality: £350 million (2016: £325 million), based on 5 per cent of the 3 year average of adjusted profit before tax. Statutory profits were adjusted to remove the effects of certain items which are exceptional and/or one-off in nature.
– Overall Bank materiality: £350 million (2016: £325 million), based on 1 per cent of total assets.
– The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).
– We performed audit procedures over components considered financially significant in the context of the Group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances). We performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to mitigate the risk of material misstatement in the residual components.

The areas of focus for our audit which involved the greatest allocation of our resources and effort were:

– Loan loss impairment provisions (Group).
– Conduct risk and provisions (Group).
– Insurance actuarial assumptions (Group).
– Defined benefit obligation (Group).
– Hedge accounting (Group and Bank).
– Significant transactions (Group and Bank).
– Privileged access to IT systems (Group and Bank).
– Disclosure of the impact of IFRS 9 (Group).

These items were discussed with the Audit Committee as part of our audit plan communicated in April 2017 and updated in October 2017. These were the key audit matters for discussion at the conclusion of our audit.

Auditors' responsibilities for the audit of the financial statements

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

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

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industries in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Bank financial statements, including but not limited to, the Companies Act 2006, the Prudential Regulation Authority's regulations, the Pensions Regulator legislation, the UK tax legislation. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, enquiries of management, review of significant components auditors' work and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We found conduct risks and provisions to be a key audit matter, and this is discussed further below. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

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

	Group financial statements	**Bank financial statements**
Overall materiality	£350 million (2016: £325 million).	£350 million (2016: £325 million).
How we determined it	5 per cent of the 3 year average of adjusted profit before tax. Profit was adjusted to remove the effects of certain items which are exceptional and/or one off in nature.	1 per cent of total assets.
Rationale for benchmark applied	We have used a 3 year average of adjusted profit before tax in order to reduce the potential for volatility and large changes in materiality year-on-year. This is a generally accepted auditing practice. Statutory profits before tax for 2015, 2016 and 2017 were adjusted to remove the disproportionate impact of several items which are considered exceptional and/or one-off in nature. These adjustments included charges related to PPI and other conduct provisions, charges relating to redemptions of enhanced capital notes and the credit in relation to the Group's disposal of its stake in Visa Europe Ltd.	We have selected total assets as an appropriate benchmark for Bank materiality. Profit based benchmarks are not considered appropriate for Bank materiality as the Group is not required to disclose a Bank income statement. Bank overall materiality calculated based on the total assets benchmark exceeds the Group overall materiality level. Therefore Bank overall materiality is restricted to equal the Group overall materiality level (£350m).

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £60 million and £120 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £20 million for the Group and Bank audits (2016: £20 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Audit scope

We tailored the scope of our audit to ensure that we performed sufficient work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group and the Bank, the accounting processes and controls, and the industry in which the Group operates.

The Group is structured into three segments being Retail, Commercial Banking, and Insurance and Wealth. Each of the segments comprises a number of components. The Group has classified the assets and liabilities of the Scottish Widows Group as a held-for-sale disposal group on the basis that a sale of its operations to its ultimate holding company, Lloyds Banking Group plc, is expected to occur within 12 months. The consolidated financial statements are a consolidation of the components.

In establishing the overall approach to the Group audit, we determined the type of work that is required to be performed over the components by us, as the Group engagement team, or auditors within PwC UK and from other PwC network firms operating under our instruction ('component auditors'). Almost all of our audit work is undertaken by PwC UK component auditors.

Where the work was performed by component auditors, we determined the level of involvement we needed to have in their audit work to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole. This included regular communication with the component auditors throughout the audit, the issuance of instructions, a review of the results of their work on the key audit matters and formal clearance meetings.

Any components which were considered individually financially significant in the context of the Group's consolidated financial statements (defined as components that represent more than or equal to 10% of the total assets of the consolidated Group) were considered full scope components. We considered the individual financial significance of other components in relation to primary statement account balances. We considered the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). Any component which was not already included as a full scope audit component but was identified as being individually financially significant in respect of one of more account balances was subject to specific audit procedures over those account balances. Inconsequential components (defined as components which did not represent a reasonable possibility of a risk of material misstatement either individually or in aggregate) were eliminated from further consideration for specific audit procedures although they were subject to Group level analytical review procedures. All remaining components which were neither inconsequential nor individually financially significant were within our audit scope, with the risk of material misstatement mitigated through audit procedures including testing of entity level controls, information technology general controls and Group and component level analytical review procedures.

Certain account balances were audited centrally by the Group engagement team.

Components within the scope of our audit contributed 93 per cent of Group total assets and 94 per cent of profit after tax.

Key audit matters
Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Loan loss impairment provisions *Group* *Refer to page 30 (Accounting Policies) and page 64 (Note 18 and Critical Accounting Estimates and Judgements).* The determination of impairment provisions is complex, and significant judgements are required around both the timing of recognition of impairment provisions and estimation of the amount of provisions required in relation to loss events which have occurred at the balance sheet date. Impairment provisions relating to loans and advances in the Retail division are determined on a collective basis, with the use of impairment models. These models are used to calculate impairment provisions based on key assumptions for example loss emergence period, probability of default, loss given default (including possession propensity and forced sale discounts for mortgages) and valuation of recoveries. These are estimated based on historical experience and other data as available at the reporting date. Management also applies overlays where they believe the calculated assumptions based on historical experience are not appropriate, either due to emerging trends or the models not capturing the risks in the loan portfolio. An example of this is an overlay to the impairment model output for the UK mortgage portfolio relating to the current low interest rate environment. These overlays require significant judgement and are therefore a main area of focus. Impairment provisions relating to loans and advances in the Commercial Banking division are primarily determined on an individual basis. Judgement is required to determine when a loan is considered impaired, and then to estimate the expected future cash flows related to that loan. A collective provision is also calculated to cover unidentified impairment (i.e. losses which have been incurred but not yet identified). Management apply overlays to the modelled output to address risks not captured by the model.	We understood management's process and tested key controls around the determination of impairment provision, including: – the identification of impairment events; – the governance over the impairment processes, including controls over unauthorised modifications to the models and the re-assessment by management that impairment models are still calibrated in a way which is appropriate for the impairment risks in the Group's loan portfolios; – the transfer of data between underlying source systems and the impairment models that the Group operates; and – the review, challenge and approval processes that are in place to assess the outputs of the Group's impairment models, and the overlays that are applied. We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit. In addition we have performed the following substantive procedures: Retail We understood and critically assessed the appropriateness of models used. This included challenging whether the portfolios were appropriately segmented and whether historical experience was representative of current circumstances. We also performed testing over the completeness and accuracy of data from underlying systems, assessed whether customer forbearance plans had been appropriately reflected in the impairment models and performed testing to obtain evidence over the existence and valuation of collateral. We critically assessed the completeness of overlays proposed by management, including challenging whether risk concentrations (e.g. past-term interest only loans, forborne loans, personal contract purchase loans) have been appropriately provided for. We also performed testing over the measurement of the overlays in place, including challenging the appropriateness of the calculation, the reasonableness of the assumptions used and the reliability of the underlying data. Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs to be appropriate. Commercial Banking We critically assessed the criteria for determining whether an impairment event had occurred and therefore whether there was a requirement to calculate an individual impairment provision. We tested a sample of performing loans with characteristics that might imply an impairment indicator existed (e.g. a customer experiencing financial difficulty or in breach of covenant) as well as an additional haphazardly selected sample of performing loans to assess whether these loans had any impairment indicators that management had not identified. For a sample of individually impaired loans, we understood the latest developments in relation to each case and the basis of measuring the impairment provisions and considered whether key judgments were appropriate given the borrower's circumstances. We also re-performed management's impairment calculation, testing key inputs including the expected future cash flows, discount rates and the valuation of collateral held. Our testing of collateral valuation specifically considered whether valuations were up to date, consistent with the strategy being followed in respect of the particular borrower and assessed the appropriateness and sensitivities of key assumptions. We back-tested previous provisions by comparing them to the gains or losses crystallised when impaired loans were sold or exited.

	For the collective unidentified impaired provision, we tested the completeness and accuracy of the underlying loan information used in the impairment models by agreeing details to the Group's source systems as well as re-performing the calculation of the modelled provision. For the key inputs and assumptions in the model, we obtained and tested objective evidence that supported their appropriateness. For overlays to the modelled output, we challenged management to provide objective evidence that the overlays were appropriate. We also considered whether certain recent events and macro-economic factors (e.g. continued volatility and uncertainty around commodity prices, sterling exchange rate movements and low interest rates) had been appropriately considered and captured. Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs are appropriate.
Conduct risk and provisions *Group* *Refer to page 30 (Accounting Policies) and page 82 (Note 32 and Critical Accounting Estimates and Judgements).* Provisions reflecting the Group's best estimate of present obligations relating to anticipated customer redress payments, operational costs and regulatory fines as a result of past events, practices and conduct continue to be significant and therefore represent a key audit matter. The most significant provisions relate to past sales of payment protection insurance (PPI) policies, arrears handling activities, packaged bank accounts and insurance products of the German branch of Clerical Medical Investment Group Ltd (now Scottish Widows Ltd). For the known issues that have been provided for, we focused on the use of several management assumptions including volume of future complaints and related redress costs that are key judgmental inputs into the measurement of provisions. Given the number and volume of products sold by the Group historically, and the continued regulatory and public focus on the banking industry, there is a continuing risk that new conduct issues will emerge. Therefore, there is a financial reporting risk that such emerging risks and exposures are not appropriately identified, for which financial statement disclosure and, or, provision may be required.	We understood and tested the key controls and management's processes around: – identifying emerging conduct risk exposures and assessing whether provisions or disclosures were necessary; and – calculating and reviewing conduct provisions, including governance processes, challenge of key assumptions and approval of provisions. We found these controls were designed, implemented and operated effectively and therefore we determined that we could place reliance on these controls for the purposes of our audit. We performed the following procedures around the measurement of provisions recognised: The majority of our detailed audit work was on the significant conduct provisions in relation to past sales of PPI policies, arrears handling activities, packaged bank accounts and insurance products in the German branch of Clerical Medical Investment Group Ltd (now Scottish Widows Ltd). We also examined other conduct provisions which are individually less material. For significant provisions made, we understood and challenged the provisioning methodologies and underlying assumptions used by management. For example, we challenged the basis that management used for forecasting the number of PPI complaints that will be received in the future. We considered regulatory developments and management's interactions with regulators. For those assumptions based on historic information, we challenged whether this was appropriate for future experience and challenged the appropriateness of any adjustments made by management. We independently performed sensitivity analysis on the key assumptions. Given the inherent uncertainty in the calculation of conduct provisions and their judgemental nature, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management around whether the disclosures were sufficiently clear in highlighting the exposures that remain, significant uncertainties that exist in respect of the provisions and the sensitivity of the provisions to changes in the underlying assumptions. Based on the procedures performed and evidence obtained, we found management's assumptions to be appropriate. We performed the following procedures around the completeness of provisions recognised: We met with Divisional and Group management to understand the emerging and potential issues that they had identified. We independently assessed emerging and potential areas where exposures might have arisen based upon our knowledge and experience of emerging industry issues and the regulatory environment. We used this to challenge the completeness of the issues identified by management and whether a provision was required. We understood the nature of customer complaints received, and assessed the trends. We used this analysis to understand whether there were indicators of more systemic issues being present for which provisions or disclosures may have needed to be made in the financial statements.

	We reviewed the Group's litigation reports, to identify potentially material cases which may require provision. We also communicated with the Group's external legal representatives to confirm our understanding of significant cases. We reviewed the Group's correspondence with the Financial Conduct Authority and Prudential Regulation Authority, discussing the content of any correspondence considered to be pertinent to our audit with management. We met on a trilateral basis with the Prudential Regulation Authority and the Chair of the Audit Committee. We also met on a bilateral basis with each regulator. We read the minutes of key governance meetings including those of the Board, and of various management committees, as well as attending all Audit Committee and Board Risk Committee meetings. No additional material conduct issues that would require financial statement disclosure or provision were identified as a result of the audit work performed.
Insurance actuarial assumptions *Group* *Refer to page 30 (Accounting Policies) and page 55 (Note 12 and Critical Accounting Estimates and Judgements).* A number of subjective assumptions about future experience contribute as key inputs into the valuation of the Group's insurance contracts. Some of the economic and non-economic actuarial assumptions used in valuing insurance contracts are highly judgemental in nature, in particular persistency (the retention of policies over time), longevity (the expectation of how long an annuity policyholder will live and how that might change over time), maintenance expenses (future expenses incurred to maintain existing policies to maturity), credit default and illiquidity premium (adjustments made to the discount rate for the IFRS value of in-force business asset). In line with the Group's accounting policy, the discount rate applied to cash flows is consistent with that applied to such cash flows in the capital markets. Management currently uses the actual asset mix as a proxy for deriving a market consistent view of the illiquidity adjustment to the discount rate.	We understood and tested key controls and governance around the processes for setting economic and non-economic assumptions. We found that the key controls for the setting of assumptions, including those operating over the experience analysis data where applicable, were designed and operated effectively. Therefore we are able to place reliance on these controls for the purposes of our financial statement audit. We engaged our actuarial specialists to assess the reasonableness of the actuarial assumptions, including the consideration and challenge of management's rationale for the judgements applied and any reliance placed on industry information. The assessment includes reference to our benchmarking data which considers each of these principal areas. For persistency, we considered the appropriateness of assumptions set by management in light of regulatory changes. In particular, we considered how the assumptions reflect expected persistency improvements from the removal of commission for qualifying pension schemes and greater outflows of funds expected as a result of increased options available to pension policyholders (Finance Act 2014). For longevity, we have assessed the appropriateness of how own experience and industry data are used in setting future assumptions around longevity experience and future longevity trends and compared resulting life expectancies to benchmarking data. For maintenance expenses, we assessed the appropriateness of the judgements around costs deemed to be non-attributable to insurance business and the resulting per-policy costs assumptions. We have reviewed the adjustments required reflecting the impact of the Group's outsourcing agreement in this area. For credit default and illiquidity premium we assessed the appropriateness of the methodology, including modifications made, against our knowledge and experience of the regulatory requirements and of the industry. We assessed the methodology with reference to wider market practice and prevailing economic conditions. We challenged whether the actual asset mix used in the illiquidity premium calculation remained an appropriate proxy to a market consistent portfolio by comparing the proportion of illiquid assets held to those held by other similar companies based on our understanding of the market and the most recent public information for other similar companies. Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs are appropriate.

Defined benefit obligation *Group* *Refer to page 30 (Accounting Policies) and page 72 (Note 30 and Critical Accounting Estimates and Judgements).* The retirement benefit schemes in the Group are calculated and valued with reference to a number of actuarial assumptions including discount rate, rate of inflation and mortality rates. As a result of the size of these schemes, small changes in these assumptions can have a significant impact on the financial statements.	We understood and tested key controls over the completeness and accuracy of data extracted and supplied to the Group's actuary, which is used in the valuation of the Group's defined benefit obligations. We tested the controls for determining the actuarial assumptions and the approval of those assumptions by senior management. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We engaged our actuarial experts and met with management and their actuary to understand the judgements made in determining key economic assumptions used in the calculation of the liability. We assessed the reasonableness of those assumptions by comparing to our own independently determined benchmarks and concluded that the assumptions used by management were appropriate. We tested the consensus and employee data used in calculating the obligation. Where material, we also considered the treatment of curtailments, settlements, past service costs and measurements, contributions and benefits paid, and any other amendments made to obligations during the year. Based on the evidence obtained, we found that the data and assumptions used by management in the actuarial valuations for pension obligations are within a range we consider to be reasonable. We read and assessed the disclosures made in the financial statements, including disclosures of the assumptions, and found them to be appropriate.
Hedge accounting *Group and Bank* *Refer to page 30 (Accounting Policies), and page 124 (Note 46).* The Group enters into derivative contracts in order to manage and hedge risks such as interest rate and foreign exchange rate risk. These arrangements create accounting mismatches which are addressed through hedge accounting, predominantly fair value hedge or cash flow hedges. The application of hedge accounting and ensuring hedge effectiveness can be highly judgemental and operationally cumbersome, and requires close monitoring from management.	We understood and tested key controls over the designation and ongoing management of hedge accounting relationships, including testing of hedge effectiveness as well as the controls around the preparation and review of hedging strategy and related documentation prior to the implementation of new hedges. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We examined hedge documentation to assess whether the documentation complied with all IAS 39 requirements. We tested key year-end reconciliations between underlying source systems and spreadsheets used to manage hedging models, including testing of hedging capacity after considering the impact of structural reform, designation of hedges and the measurement and recording of hedge effectiveness adjustments. In monitoring hedging effectiveness against stresses, we noted that despite significant market uncertainty and volatility during the year, all significant hedge accounting relationships continued to be effective. We tested a sample of manual adjustments posted to hedge reserves relating to hedge ineffectiveness arising in cash flow hedging models. We found that hedge accounting methodology was appropriately applied.
Significant transactions *Group and Bank* During the year, the Group has entered into significant one-off transactions that inherently have a high level of complexity and/or judgment in its determination of accounting treatment (e.g. acquisition of MBNA). This judgment increases the risk of management bias being introduced into the transactions. Due to the nature of significant one-off transactions, the accounting often falls outside of the business as usual process level controls and requires manual calculations to be performed. The design of the initial accounting treatment may form the basis for subsequent periods for long dated transactions.	We understood and tested key controls which require that one-off transactions are referred to Group Financial Reporting and that an accounting paper is produced outlining the treatment of the transaction in the financial statements. Further to this, we ensured that the accounting paper is appropriately reviewed and approved. We found the key controls were designed, implemented and operated effectively. We understood the nature of the significant transactions and reviewed the accounting papers produced in the year including any transaction documents or contracts to evaluate and assess the impact of the transaction on the Group. We made our own assessment as to the most appropriate accounting treatment, using this as a basis to challenge the key judgements made by management, including the assessment of any potential management bias. We assessed whether the extent of the disclosures made, in relation to significant transactions was appropriate. Based on the results of the evidence obtained, we found the accounting treatments applied to significant transactions were supported by the evidence obtained.

Privileged access to IT systems

Group and Bank

The Group's financial reporting processes are reliant on automated processes and controls performed by IT systems. Further, the group-wide IT estate is complex in terms of the scale and nature of IT systems relied upon. The risks associated with IT are also impacted by the threat profile of IT within the banking environment, which is subject to a number of internal and external risks relating to cyber security and the resilience of IT systems.

As part of the audit, we validate the design and operating effectiveness of in-scope automated and IT dependent controls over financial reporting at a point in time as well as review the supporting IT General Computer Controls (ITGCs) that provide assurance over the continued integrity of these controls for the full financial reporting period.

As part of our audit work in prior periods, we identified recurring control matters in relation to the management of IT privileged access to IT systems and therefore have relied on compensating controls and performed additional procedures.

While there is an ongoing programme of activities to address such control matters, the fact that these were open control matters during the period meant there was an increased risk that the data and reports from the affected systems were not reliable.

We understood and tested key controls surrounding Group IT's central process for the periodic recertification of user access entitlements across in-scope systems as well as reviewed the processes for managing privileged access to IT systems.

We have obtained an understanding of management's remediation programme and observed progress in terms of their remediation of a number of the control matters. However, several of the controls continued to be ineffective for the full financial reporting period.

Where these control matters affected applications and supporting IT systems within the scope of our audit, we performed a combination of additional controls testing, including compensating controls where relevant and substantive audit procedures.

On the basis of our additional audit testing, we were able to place reliance on the data and reports from in-scope applications.

Disclosure of the impact of IFRS 9

Group

Refer to page 144 (Note 50).

On 1 January 2018, the Group transitioned to the new financial instruments accounting standard IFRS 9, which replaced IAS 39. The estimated transition impact is disclosed in Note 50 to the Financial Statements in accordance with IAS 8. Disclosures in 2017 are intended to provide users with an understanding of the estimated impact of the new standard, and as a result are more limited than the disclosure to be included in the 2018 financial statements.

We have deemed the disclosure of the impact of IFRS 9 for impairment an area of focus because of the significant changes introduced by the standard. Under the new impairment model, losses are recognised on an expected credit loss basis. Expected credit losses ("ECLs") are required to incorporate forward-looking information, reflecting management's view of potential future economic environments. The complexity involved requires management to develop new methodologies involving the use of significant judgements.

Separately, the standard introduces new requirements around the classification and measurement of financial instruments, potentially resulting in fair value differences.

In order to meet the requirements of the new standard, significant changes have also been made to systems, processes and controls with effect from 1 January 2018.

We understood and tested key controls supporting management's estimate of the transition adjustment focussing on:

- model development, validation and approval to ensure compliance with IFRS 9 requirements;
- review and approval of key assumptions, judgements and forward looking information prior to use in the models;
- the integrity of data used as input to the models including the transfer of data between source systems and the impairment models;
- review and approval of post model adjustments recorded by management; and
- review and approval of the output of IFRS 9 models and related transition impacts.

We noted the controls were designed and operated effectively in all material respects.

We understood and critically assessed classification and measurement decisions and the ECL models developed by the Group. This included using our credit modelling experts in our assessment of judgements and assumptions supporting the ECL requirements of the standard. We re-performed certain model calculations to confirm the risk parameter outputs and the results were appropriate.

We assessed the reasonableness of forward looking information incorporated into the impairment calculations by using our experts and specialists to challenge the multiple economic scenarios chosen and the weighting applied to capture non-linear losses.

We considered post-model adjustments in the context of key model and data limitations identified by management, challenged their rationale and recalculated where necessary.

We tested the underlying disclosures related to the transition impact and reconciled the disclosed impact to underlying accounting records.

Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models, resulting outputs and overlays to modelled outputs are appropriate.

Independent auditors' report

Conclusions relating to going concern
In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the Bank's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Bank's ability to continue as a going concern.

As noted in the directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. In drawing this conclusion the directors have considered:

– the regulatory capital position of the Group which is critical to the market maintaining confidence in the Group's ability to absorb losses that it may incur in a market stress; and
– the funding and liquidity position of the Group to be able to meet its liabilities as they fall due, including in a market stress.

As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. In drawing our conclusion, we critically assessed the going concern assessment undertaken by management and approved by the Board of Directors. As part of our assessment we have:

– evaluated the appropriateness of the stress scenarios used and their impact on the Group's and Bank's capital and liquidity positions;
– evaluated the key economic and other assumptions used in both the capital and liquidity plans and the Group's operating plan; and
– substantiated the Group's and Bank's access to unencumbered collateral placed with, and liquidity facilities available from, the central bank.

Reporting on other information
The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' report, we considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06) and ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Bank and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' report. (CA06)

Responsibilities for the financial statements and the audit
Responsibilities of the directors for the financial statements
As explained more fully in the Statement of directors' responsibilities are set out on page 8, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the 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.

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

Other required reporting

Companies Act 2006 exception reporting

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

– we have not received all the information and explanations we require for our audit; or
– adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
– certain disclosures of directors' remuneration specified by law are not made; or
– the Bank financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 21 December 1995 to audit the financial statements for the year ended 31 December 1995 and subsequent financial periods. The period of total uninterrupted engagement is 23 years, covering the years ended 31 December 1995 to 31 December 2017. The audit was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation for the 2021 audit of the ultimate parent, Lloyds Banking Group plc.

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

13 March 2018

Consolidated income statement

for the year ended 31 December 2017

	Note	2017 £ million	2016 £ million
Interest and similar income		**15,853**	16,671
Interest and similar expense		**(3,489)**	(5,477)
Net interest income	5	**12,364**	11,194
Fee and commission income		**2,786**	2,844
Fee and commission expense		**(1,024)**	(943)
Net fee and commission income	6	**1,762**	1,901
Net trading income	7	**773**	942
Other operating income	8	**2,453**	443
Other income		**4,988**	3,286
Total income		**17,352**	14,480
Regulatory provisions		**(2,122)**	(2,271)
Other operating expenses		**(9,508)**	(9,480)
Total operating expenses	9	**(11,630)**	(11,751)
Trading surplus		**5,722**	2,729
Impairment	10	**(687)**	(752)
Profit before tax – continuing operations		**5,035**	1,977
Tax expense	11	**(1,602)**	(947)
Profit after tax – continuing operations		**3,433**	1,030
Profit after tax – discontinued operations	12	**796**	173
Profit for the year		**4,229**	1,203
Profit attributable to ordinary shareholders		**3,866**	983
Profit attributable to other equity holders[1]		**273**	119
Profit attributable to equity holders		**4,139**	1,102
Profit attributable – non-controlling interests		**90**	101
Profit for the year		**4,229**	1,203

[1] The profit after tax attributable to other equity holders of £273 million (2016: £119 million) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £74 million (2016: £33 million).

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

Statements of comprehensive income

for the year ended 31 December 2017

The Group	2017 £ million	2016 £ million
Profit for the year	**4,229**	1,203
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before tax	**628**	(1,348)
Tax	**(146)**	320
	482	(1,028)
Gains and losses attributable to own credit risk:		
Gains (losses) before tax	**(55)**	–
Tax	**15**	–
	(40)	–
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Adjustment on transfer from held-to-maturity portfolio	**–**	1,544
Change in fair value	**294**	356
Income statement transfers in respect of disposals	**(464)**	(575)
Income statement transfers in respect of impairment	**6**	173
Tax	**64**	(301)
	(100)	1,197
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**(271)**	2,284
Net income statement transfers	**(644)**	(531)
Tax	**264**	(444)
	(651)	1,309
Currency translation differences (tax: nil)	**(27)**	(9)
Other comprehensive income for the year, net of tax	**(336)**	1,469
Total comprehensive income for the year	**3,893**	2,672
Total comprehensive income attributable to ordinary shareholders arising from continuing operations	**2,681**	2,342
Total comprehensive income attributable to ordinary shareholders arising from discontinued operations	**849**	110
Total comprehensive income attributable to ordinary shareholders	**3,530**	2,452
Total comprehensive income attributable to other equity holders	**273**	119
Total comprehensive income attributable to equity holders	**3,803**	2,571
Total comprehensive income attributable to non-controlling interests	**90**	101
Total comprehensive income for the year	**3,893**	2,672

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

Statements of comprehensive income

for the year ended 31 December 2017

The Bank	2017 £ million	2016 £ million
Profit for the year	**5,279**	1,953
Other comprehensive income:		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before tax	**442**	(682)
Tax	**(110)**	184
	332	(498)
Gains and losses attributable to own credit risk:		
Gains (losses) before tax	**(55)**	–
Tax	**15**	–
	(40)	–
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Adjustment on transfer from held-to-maturity portfolio	**–**	1,544
Change in fair value	**231**	268
Income statement transfers in respect of disposals	**(333)**	(507)
Income statement transfers in respect of impairment	**–**	172
Tax	**46**	(269)
	(56)	1,208
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**15**	1,290
Net income statement transfers	**(436)**	(241)
Tax	**130**	(258)
	(291)	791
Currency translation differences (tax: nil)	**(5)**	19
Other comprehensive income for the year, net of tax	**(60)**	1,520
Total comprehensive income for the year	**5,219**	3,473
Total comprehensive income attributable to ordinary shareholders	**4,946**	3,354
Total comprehensive income attributable to other equity holders	**273**	119
Total comprehensive income for the year	**5,219**	3,473

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

Balance sheets

at 31 December 2017

		The Group		The Bank	
	Note	**2017 £ million**	2016 £ million	**2017 £ million**	2016 £ million
Assets					
Cash and balances at central banks		**58,521**	47,452	**55,835**	44,595
Items in the course of collection from banks		**755**	706	**490**	512
Trading and other financial assets at fair value through profit or loss	13	**45,608**	51,198	**43,977**	48,309
Derivative financial instruments	14	**24,152**	33,859	**26,764**	36,714
Loans and receivables:					
Loans and advances to banks		**4,274**	5,583	**3,611**	4,379
Loans and advances to customers	15	**465,555**	451,282	**170,804**	161,161
Debt securities		**3,637**	3,397	**3,182**	2,818
Due from fellow Lloyds Banking Group undertakings		**6,195**	5,624	**180,772**	152,260
		479,661	465,886	**358,369**	320,618
Available-for-sale financial assets	19	**41,717**	56,524	**42,566**	55,122
Goodwill	21	**474**	180	**–**	–
Other intangible assets	22	**2,666**	1,520	**1,415**	893
Property, plant and equipment	23	**9,062**	9,294	**3,252**	3,644
Current tax recoverable		**16**	28	**–**	420
Deferred tax assets	31	**3,104**	3,603	**1,995**	2,286
Investment in subsidiary undertakings	24	**–**	–	**32,878**	31,135
Retirement benefit assets	30	**723**	342	**673**	254
Assets of held-for-sale disposal group	12, 24	**154,227**	158,194	**7,622**	7,622
Other assets	25	**2,344**	2,141	**1,117**	1,168
Total assets		**823,030**	830,927	**576,953**	553,292

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

Balance sheets

at 31 December 2017

		The Group		The Bank	
Equity and liabilities	Note	**2017 £ million**	2016 £ million	**2017 £ million**	2016 £ million
Liabilities					
Deposits from banks		**28,888**	15,690	**7,538**	9,450
Customer deposits	26	**418,124**	415,460	**234,397**	213,135
Due to fellow Lloyds Banking Group undertakings		**13,237**	5,444	**112,769**	86,803
Items in course of transmission to banks		**579**	548	**304**	292
Trading and other financial liabilities at fair value through profit or loss	27	**50,874**	54,504	**51,045**	55,776
Derivative financial instruments	14	**24,699**	33,896	**28,267**	38,591
Notes in circulation		**1,313**	1,402	**–**	–
Debt securities in issue	28	**61,865**	74,733	**66,249**	74,366
Liabilities of held-for-sale disposal group	12	**146,518**	150,938	**–**	–
Other liabilities	29	**4,540**	4,732	**3,425**	3,295
Retirement benefit obligations	30	**281**	692	**143**	399
Current tax liabilities		**827**	446	**105**	3
Deferred tax liabilities	31	**–**	–	**–**	–
Other provisions	32	**5,309**	4,933	**2,593**	2,833
Subordinated liabilities	33	**14,782**	17,258	**9,341**	10,575
Total liabilities		**771,836**	780,676	**516,176**	495,518
Equity					
Share capital	34	**1,574**	1,574	**1,574**	1,574
Share premium account	35	**600**	–	**600**	–
Other reserves	36	**7,706**	8,484	**2,241**	2,593
Retained profits[1]	37	**37,718**	36,231	**53,145**	50,390
Shareholders' equity		**47,598**	46,289	**57,560**	54,557
Other equity instruments	38	**3,217**	3,217	**3,217**	3,217
Total equity excluding non-controlling interests		**50,815**	49,506	**60,777**	57,774
Non-controlling interests		**379**	745	**–**	–
Total equity		**51,194**	50,251	**60,777**	57,774
Total equity and liabilities		**823,030**	830,927	**576,953**	553,292

[1] The Bank recorded a profit after tax for the year of £5,279 million (2016: £1,953 million).

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

The directors approved the financial statements on 13 March 2018.

Lord Blackwell
Chairman

António Horta-Osório
Chief Executive

George Culmer
Chief Financial Officer

Statements of changes in equity

for the year ended 31 December 2017

The Group	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
	Attributable to equity shareholders						
Balance at 1 January 2016	37,107	5,987	3,868	46,962	–	391	47,353
Comprehensive income							
Profit for the year	–	–	1,102	1,102	–	101	1,203
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(1,028)	(1,028)	–	–	(1,028)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	1,197	–	1,197	–	–	1,197
Movements in cash flow hedging reserve, net of tax	–	1,309	–	1,309	–	–	1,309
Currency translation differences (tax: nil)	–	(9)	–	(9)	–	–	(9)
Total other comprehensive income	–	2,497	(1,028)	1,469	–	–	1,469
Total comprehensive income	–	2,497	74	2,571	–	101	2,672
Transactions with owners							
Dividends (note 39)	–	–	(3,040)	(3,040)	–	(29)	(3,069)
Distributions on other equity instruments, net of tax	–	–	(86)	(86)	–	–	(86)
Issue of other equity instruments	–	–	–	–	3,217	–	3,217
Redemption of preference shares	1,840	–	(1,840)	–	–	–	–
Capital restructuring	(37,373)	–	37,373	–	–	–	–
Capital contribution received	–	–	323	323	–	–	323
Return of capital contributions	–	–	(441)	(441)	–	–	(441)
Changes in non-controlling interests	–	–	–	–	–	282	282
Total transactions with owners	(35,533)	–	32,289	(3,244)	3,217	253	226
Balance at 31 December 2016	1,574	8,484	36,231	46,289	3,217	745	50,251
Comprehensive income							
Profit for the year	–	–	**4,139**	**4,139**	–	**90**	**4,229**
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**482**	**482**	**–**	**–**	**482**
Movements in revaluation reserve in respect of available-for-sale financial assets, (tax: nil)	**–**	**(100)**	–	**(100)**	**–**	**–**	**(100)**
Gains and losses attributable to own credit risk, net of tax	**–**	–	**(40)**	**(40)**	**–**	**–**	**(40)**
Movements in cash flow hedging reserve, net of tax	**–**	**(651)**	–	**(651)**	**–**	**–**	**(651)**
Currency translation differences (tax: nil)	**–**	**(27)**	–	**(27)**	**–**	–	**(27)**
Total other comprehensive income	**–**	**(778)**	**442**	**(336)**	**–**	**–**	**(336)**
Total comprehensive income	**–**	**(778)**	**4,581**	**3,803**	**–**	**90**	**3,893**
Transactions with owners							
Dividends (note 39)	**–**	**–**	**(2,650)**	**(2,650)**	**–**	**(69)**	**(2,719)**
Distributions on other equity instruments, net of tax	**–**	**–**	**(199)**	**(199)**	**–**	**–**	**(199)**
Redemption of preference shares (note 35)	**600**	**–**	**(600)**	**–**	**–**	**–**	**–**
Capital contribution received	**–**	**–**	**432**	**432**	**–**	**–**	**432**
Return of capital contributions	**–**	**–**	**(77)**	**(77)**	**–**	**–**	**(77)**
Changes in non-controlling interests	**–**	**–**	**–**	**–**	**–**	**(387)**	**(387)**
Total transactions with owners	**600**	**–**	**(3,094)**	**(2,494)**	**–**	**(456)**	**(2,950)**
Balance at 31 December 2017	**2,174**	**7,706**	**37,718**	**47,598**	**3,217**	**379**	**51,194**

Further details of movements in the Group's share capital and reserves are provided in notes 34, 35, 36, 37 and 38.

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

Statements of changes in equity

for the year ended 31 December 2017

The Bank	Attributable to equity shareholders Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Other equity instruments £ million	Total £ million
Balance at 1 January 2016	37,107	575	16,646	–	54,328
Comprehensive income					
Profit for the year	–	–	1,953	–	1,953
Other comprehensive income					
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(498)	–	(498)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	1,208	–	–	1,208
Movements in cash flow hedging reserve, net of tax	–	791	–	–	791
Currency translation differences (tax: nil)	–	19	–	–	19
Total other comprehensive income	–	2,018	(498)	–	1,520
Total comprehensive income	–	2,018	1,455	–	3,473
Transactions with owners					
Dividends (note 39)	–	–	(3,040)	–	(3,040)
Distributions on other equity instruments, net of tax	–	–	(86)	–	(86)
Issue of other equity instruments (note 38)	–	–	–	3,217	3,217
Redemption of preference shares (note 35)	1,840	–	(1,840)	–	–
Capital restructuring (note 35)	(37,373)	–	37,373	–	–
Capital contributions received	–	–	323	–	323
Return of capital contributions	–	–	(441)	–	(441)
Total transactions with owners	(35,533)	–	32,289	3,217	(27)
Balance at 31 December 2016	1,574	2,593	50,390	3,217	57,774
Comprehensive income					
Profit for the year	**–**	**–**	**5,279**	**–**	**5,279**
Other comprehensive income					
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**332**	**–**	**332**
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	**–**	**(56)**	**–**	**–**	**(56)**
Gains and losses attributable to own credit risk, net of tax	**–**	**–**	**(40)**	**–**	**(40)**
Movements in cash flow hedging reserve, net of tax	**–**	**(291)**	**–**	**–**	**(291)**
Currency translation differences (tax: nil)	**–**	**(5)**	**–**	**–**	**(5)**
Total other comprehensive income	**–**	**(352)**	**292**	**–**	**(60)**
Total comprehensive income	**–**	**(352)**	**5,571**	**–**	**5,219**
Transactions with owners					
Dividends (note 39)	**–**	**–**	**(2,650)**	**–**	**(2,650)**
Distributions on other equity instruments, net of tax	**–**	**–**	**(199)**	**–**	**(199)**
Redemption of preference shares (note 35)	**600**	**–**	**(600)**	**–**	**–**
Capital contribution received	**–**	**–**	**432**	**–**	**432**
Return of capital contributions	**–**	**–**	**(77)**	**–**	**(77)**
Total transactions with owners	**600**	**–**	**(3,094)**	**–**	**(2,494)**
Adjustment on vesting of businesses (note 24)	**–**	**–**	**278**	**–**	**278**
Balance at 31 December 2017	**2,174**	**2,241**	**53,145**	**3,217**	**60,777**

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

Cash flow statements

for the year ended 31 December 2017

	Note	The Group 2017 £ million	The Group 2016 £ million	The Bank 2017 £ million	The Bank 2016 £ million
Profit before tax[1]		**5,978**	2,556	**5,808**	2,030
Adjustments for:					
Change in operating assets	48(a)	**(15,733)**	(3,300)	**(9,114)**	(20,951)
Change in operating liabilities	48(b)	**(13,379)**	(2,029)	**1,412**	21,253
Non-cash and other items	48(c)	**12,297**	13,871	**(1,973)**	(1,913)
Tax received (paid)		**(682)**	(130)	**437**	654
Net cash provided by operating activities		**(11,519)**	10,968	**(3,430)**	1,073
Cash flows from investing activities					
Purchase of financial assets		**(7,857)**	(4,930)	**(7,550)**	(4,664)
Proceeds from sale and maturity of financial assets		**18,667**	6,335	**16,480**	6,429
Purchase of fixed assets		**(3,655)**	(3,760)	**(1,155)**	(1,122)
Proceeds from sale of fixed assets		**1,444**	1,684	**85**	19
Additional capital injections to subsidiaries	48(e)	**–**	–	**(34)**	(81)
Dividends received from subsidiaries		**–**	–	**4,378**	3,984
Distributions on other equity instruments received		**–**	–	**101**	–
Acquisition of businesses, net of cash acquired	48(e)	**(1,913)**	(20)	**(2,026)**	–
Disposal of businesses, net of cash disposed	48(f)	**984**	5	**592**	3
Net cash (used in) provided by investing activities		**7,670**	(686)	**10,871**	4,568
Cash flows from financing activities					
Dividends paid to ordinary shareholders		**(2,650)**	(3,040)	**(2,650)**	(3,040)
Distributions on other equity instruments		**(273)**	(119)	**(273)**	(119)
Dividends paid to non-controlling interests		**(69)**	(29)	**–**	–
Return of capital contribution		**(77)**	(441)	**(77)**	(441)
Interest paid on subordinated liabilities		**(1,157)**	(2,003)	**(668)**	(1,516)
Proceeds from issue of Additional Tier 1 securities		**–**	3,217	**–**	3,217
Proceeds from issue of subordinated liabilities		**–**	2,753	**–**	2,753
Repayment of subordinated liabilities		**(1,608)**	(15,207)	**(675)**	(13,200)
Borrowings from parent company		**8,476**	305	**8,476**	–
Repayments to parent company		**(475)**	(4,585)	**(475)**	(3,387)
Interest paid on borrowing from parent company		**(244)**	(496)	**(244)**	(496)
Other changes in non-controlling interests		**–**	297	**–**	–
Net cash used in financing activities		**1,923**	(19,348)	**3,414**	(16,229)
Effect of exchange rate changes on cash and cash equivalents		**–**	21	**(1)**	2
Change in cash and cash equivalents		**(1,926)**	(9,045)	**10,854**	(10,586)
Cash and cash equivalents at beginning of year		**62,908**	71,953	**45,266**	55,852
Cash and cash equivalents at end of year	48(d)	**60,982**	62,908	**56,120**	45,266

[1] Group profit before tax comprises £5,035 million in respect of continuing operations and £943 million in respect of discontinued operations (2016: £1,977 million in respect of continuing operations and £579 million in respect of discontinued operations).

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

Discontinued operations
The impact of the Group's discontinued operations on the above Cash flow statements is as follows:

	The Group 2017 £ million	The Group 2016 £ million
Net cash (used in) provided by operating activities	**(12,244)**	804
Net cash from investing activities	**208**	471
Net cash used in financing activities	**(115)**	(417)
Change in cash and cash equivalents	**(12,151)**	858

1 Basis of preparation

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

To improve transparency and ease of reference, the capital resources disclosure required under IFRS has been included within the Strategic Report on page 4. This disclosure is covered by the Audit opinion (included on pages 12 to 20) and referenced as audited.

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 considered a number of key dependencies which are set out in the Principal risks and uncertainties section under Funding and liquidity on page 6 and additionally have considered projections for the Group's capital and funding position. Taking all of these factors into account, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

With effect from 1 January 2017 the Group has elected to early adopt the provision in IFRS 9 for gains and losses attributable to changes in own credit risk on financial liabilities designated at fair value through profit or loss to be presented in other comprehensive income. The impact on the Group and on the Bank has been to increase profit after tax and reduce other comprehensive income by £40 million in the year ended 31 December 2017; there is no impact on total liabilities or shareholders' equity. Comparatives have not been restated.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2017 and which have not been applied in preparing these financial statements are given in note 49.

2 Accounting policies

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

a Consolidation
The assets, liabilities and results of Group undertakings (including structured entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include subsidiaries, associates and joint ventures. Details of the Group's subsidiaries and related undertakings are given on pages 146 to 154.

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

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

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

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

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

The acquisition method of accounting is used to account for business combinations by the Group. The consideration for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred except those relating to the issuance of debt instruments (see 2e(5)) or share capital (see 2p). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

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

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated at initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for by the equity method of accounting.

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

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

2 Accounting policies (continued)

c Other intangible assets
Intangible assets which have been determined to have a finite useful life are amortised on a straight line basis over their estimated useful life as follows: up to 7 years for capitalised software; 10 to 15 years for brands and other intangibles.

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

d Revenue recognition
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest method, except for those classified at fair value through profit or loss. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability, including early redemption fees, and related penalties; and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account.

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan once drawn. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility.

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

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

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

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

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

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

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

Classified at fair value through profit and loss: Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur, except that gains and losses attributable to changes in own credit risk on financial liabilities held at fair value through profit or loss are taken directly to other comprehensive income (see note 1). Financial assets and liabilities are designated at fair value through profit or loss on acquisition in the following circumstances:

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

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. Refer to note 43(c) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

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

2 Accounting policies (continued)

comprehensive income is recognised in the income statement. Interest calculated using the effective interest method and foreign exchange gains and losses on debt securities denominated in foreign currencies are recognised in the income statement.

The Group is permitted to transfer a financial asset from the available-for-sale category to the loans and receivables category where that asset would otherwise have met the definition of loans and receivables at the time of reclassification and where there is both the intention and ability to hold that financial asset for the foreseeable future. Reclassification of a financial asset from the available-for-sale category to the held-to-maturity category is permitted when the Group has the ability and intent to hold that financial asset to maturity. Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable. Effective interest rates for financial assets reclassified to the loans and receivables and held-to-maturity categories are determined at the reclassification date. Any previous gain or loss on a transferred asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest method or until the asset becomes impaired. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest method.

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

(3) Loans and receivables

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

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

(4) Borrowings

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

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

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

(5) Sale and repurchase agreements

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

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

f Derivative financial instruments and hedge accounting

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS 39. All derivatives are recognised at their fair value. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 48(c) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

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

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

The method of recognising the movements in the fair value of derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item, 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.

(1) Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk; this also applies if the hedged asset is classified as an available-for-sale financial asset. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no

2 Accounting policies (continued)

longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity.

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

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

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

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

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

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

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

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

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

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

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

2 Accounting policies (continued)

of 10 years and, if lease renewal is not likely, the remaining period of the lease for leasehold improvements; 10 to 20 years for fixtures and furnishings; and 2 to 8 years for other equipment and motor vehicles.

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

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

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital accretion or both, primarily within the life insurance funds. In accordance with the guidance published by the Royal Institution of Chartered Surveyors, investment property is carried at fair value based on current prices for similar properties, adjusted for the specific characteristics of the property (such as location or condition). If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices in less active markets. These valuations are reviewed at least annually by independent professionally qualified valuers. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be valued at fair value.

j Leases

(1) As lessee

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

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

(2) As lessor

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

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

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

k Employee benefits

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

(1) Pension schemes

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

Scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

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

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

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

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

(2) Share-based compensation

Lloyds Banking Group operates a number of equity-settled, share-based compensation plans in respect of services received from certain of its employees. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model or a Monte Carlo simulation. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to

2 Accounting policies (continued)

estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement.

l Taxation
Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

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

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

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

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

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

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

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

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

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

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

The general insurance business issues only insurance contracts.

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

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

- *Insurance and participating investment contracts in the Group's with-profit funds*
  Liabilities of the Group's with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Prudential Regulation Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in the unallocated surplus (see below).

2 Accounting policies (continued)

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

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

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

Insurance and participating investment contracts which are unit-linked

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

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

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

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

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

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

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

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

(2) General insurance business
The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet within liabilities arising from insurance contracts and participating investment contracts on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of the contract and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

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

(3) Liability adequacy test
At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities net of related deferred cost assets and value of in-force business. In performing these tests current best estimates of discounted future contractual cash flows and claims handling and policy administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the income statement, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from liability adequacy tests.

2 Accounting policies (continued)

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

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

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

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

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

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

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

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

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

p Share capital
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.

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

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

s Disposal groups held for sale and discontinued operations
Disposal groups are classified as held for sale if the Group will recover the carrying amount principally through a sale transaction rather than through continuing use and a sale is considered highly probable. Disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Assets and liabilities of disposal groups classified as held for sale are shown separately on the face of the balance sheet.

A discontinued operation is a cash generating unit or a group of cash generating units that has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale. The results after tax of discontinued operations are shown as a single line item on the face of the income statement.

3 Critical accounting estimates

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

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

- Allowance for impairment losses on loans and receivables (note 18);
- Valuation of assets and liabilities arising from insurance business (note 12);
- Defined benefit pension scheme obligations (note 30);
- Recoverability of deferred tax assets (note 31);
- Payment protection insurance and other regulatory provisions (note 32); and
- Fair value of financial instruments (note 43).

4 Segmental analysis

The Lloyds Bank Group provides a wide range of banking and financial services in the UK and in certain locations overseas.

The Group Executive Committee (GEC) of the Lloyds Banking Group has been determined to be the chief operating decision maker for the Group. The Group's operating segments reflect its organisational and management structures. The Group Executive Committee reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources. GEC considers interest income and expense on a net basis and consequently the total interest income and expense for all reportable segments is presented net. The segments are differentiated by the type of products provided, by whether the customers are individuals or corporate entities.

Following the transfer of HBOS to the Group on 1 January 2010, all of the trading activities of the Lloyds Banking Group are carried out within the Group and, as a result, the chief operating decision maker reviews the Group's performance by considering that of the Lloyds Banking Group; this has remained the case throughout 2016 and 2017. Since the chief operating decision maker's review includes the Lloyds Banking Group's insurance operations, the Scottish Widows group is not treated as a discontinued operation for the Bank's segmental reporting purposes.

The segmental results and comparatives are presented on an underlying basis, the basis reviewed by the chief operating decision maker. The effects of the following are excluded in arriving at underlying profit:

- losses on redemption of the Enhanced Capital Notes and the volatility in the value of the embedded equity conversion feature;
- market volatility and asset sales, which includes the effects of certain asset sales, the volatility relating to the Group's own debt and hedging arrangements and that arising in the insurance businesses and insurance gross up;
- the unwind of acquisition-related fair value adjustments and the amortisation of purchased intangible assets;
- restructuring costs, comprising costs relating to the Simplification programme and the costs of implementing regulatory reform and ring-fencing, the rationalisation of the non-branch property portfolio and the integration of MBNA; and
- payment protection insurance and other conduct provisions.

For the purposes of the underlying income statement, operating lease depreciation (net of gains on disposal of operating lease assets) is shown as an adjustment to total income.

As part of a Group restructuring during 2017:

- the Consumer Finance division has now become part of Retail;
- the Group's UK wealth business, previously part of Retail, has been transferred to the Insurance division, now renamed Insurance and Wealth;
- the Group's International wealth business, previously part of Retail, has been transferred to the Commercial Banking division; and
- the Group's venture capital business, previously part of Commercial Banking, has been transferred to Other.

Comparatives have been restated accordingly. Following this restructuring, the Group's activities are now organised into three financial reporting segments: Retail; Commercial Banking; and Insurance and Wealth.

Retail offers a broad range of financial service products, including current accounts, savings, mortgages, motor finance and unsecured consumer lending to personal and small business customers.

Commercial Banking provides a range of products and services such as lending, transactional banking, working capital management, risk management and debt capital markets services to SMEs, corporates and financial institutions.

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

Other includes certain assets previously reported as outside of the Group's risk appetite and income and expenditure not attributed to divisions, including the costs of certain central and head office functions and the Group's private equity business, Lloyds Development Capital.

Inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

4 Segmental analysis (continued)

For the majority of those derivative contracts entered into by business units for risk management purposes, the business unit recognises the net interest income or expense on an accrual accounting basis and transfers the remainder of the movement in the fair value of the derivative to the central group segment where the resulting accounting volatility is managed where possible through the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the derivative and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results and leads to accounting volatility, which is managed centrally and reported within Other.

	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Other £m	Underlying basis total £m
Year ended 31 December 2017					
Net interest income	8,706	3,086	133	395	12,320
Other income, net of insurance claims	2,217	1,761	1,846	381	6,205
Total underlying income, net of insurance claims	10,923	4,847	1,979	776	18,525
Operating lease depreciation[1]	(946)	(44)	–	(63)	(1,053)
Net income	9,977	4,803	1,979	713	17,472
Operating costs	(4,857)	(2,199)	(1,040)	(88)	(8,184)
Impairment (charge) credit	(717)	(115)	–	37	(795)
Underlying profit	4,403	2,489	939	662	8,493
External income	12,651	3,093	1,883	898	18,525
Inter-segment income	(1,728)	1,754	96	(122)	–
Segment underlying income, net of insurance claims	10,923	4,847	1,979	776	18,525
Segment external assets	349,116	174,081	151,986	136,926	812,109
Segment customer deposits	253,127	147,588	13,770	3,639	418,124
Segment external liabilities	258,423	223,543	157,824	123,176	762,966
Other segment items reflected in income statement above:					
Depreciation and amortisation	1,545	259	197	369	2,370
Decrease in value of in-force business	–	–	(165)	–	(165)
Defined benefit scheme charges	137	48	25	149	359
Other segment items:					
Additions to fixed assets	2,431	107	274	843	3,655
Investments in joint ventures and associates at end of year	9	–	–	56	65

[1] Net of profits on disposal of operating lease assets of £32 million.

4 Segmental analysis (continued)

	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Other £m	Underlying basis total £m
Year ended 31 December 2016[1]					
Net interest income	8,073	2,934	80	348	11,435
Other income, net of insurance claims	2,162	1,756	1,939	208	6,065
Total underlying income, net of insurance claims	10,235	4,690	2,019	556	17,500
Operating lease depreciation[2]	(775)	(105)	–	(15)	(895)
Net income	9,460	4,585	2,019	541	16,605
Operating costs	(4,748)	(2,189)	(1,046)	(110)	(8,093)
Impairment (charge) credit	(654)	(17)	–	26	(645)
Underlying profit (loss)	4,058	2,379	973	457	7,867
External income	12,203	3,408	1,434	455	17,500
Inter-segment income	(1,968)	1,282	585	101	–
Segment underlying income, net of insurance claims	10,235	4,690	2,019	556	17,500
Segment external assets	338,939	187,405	154,782	136,667	817,793
Segment customer deposits	256,453	141,302	13,798	3,907	415,460
Segment external liabilities	264,915	230,030	160,815	113,218	768,978
Other segment items reflected in income statement above:					
Depreciation and amortisation	1,343	313	169	555	2,380
Increase in value of in-force business	–	–	472	–	472
Defined benefit scheme charges	141	49	31	66	287
Other segment items:					
Additions to fixed assets	2,362	126	481	791	3,760
Investments in joint ventures and associates at end of year	6	–	–	53	59

[1] Restated, see page 38.

[2] Net of profits on disposal of operating lease assets of £58 million.

Reconciliation of underlying basis to statutory results

	Lloyds Bank Group				Removal of:				
	Continuing operations £m	Discontinued operations £m	Adjustments £m	Impact of other entities in the Lloyds Banking Group[1] £m	Volatility and other items[2] £m	Insurance gross up[3] £m	PPI £m	Other conduct provisions £m	Underlying basis £m
Year ended 31 December 2017									
Net interest income	**12,364**	**(1,313)**	**–**	**(139)**	**228**	**1,180**	**–**	**–**	**12,320**
Other income, net of insurance claims	**4,988**	**3,251**	**(553)**	**61**	**(186)**	**(1,356)**	**–**	**–**	**6,205**
Total income, net of insurance claims	**17,352**	**1,938**	**(553)**	**(78)**	**42**	**(176)**	**–**	**–**	**18,525**
Operating lease depreciation[4]					**(1,053)**	**–**	**–**	**–**	**(1,053)**
Net income	**17,352**	**1,938**	**(553)**	**(78)**	**(1,011)**	**(176)**	**–**	**–**	**17,472**
Operating expenses	**(11,630)**	**(995)**	**553**	**(274)**	**1,821**	**176**	**1,300**	**865**	**(8,184)**
Impairment	**(687)**	**–**	**–**	**(1)**	**(107)**	**–**	**–**	**–**	**(795)**
Profit	**5,035**	**943**	**–**	**(353)**	**703**	**–**	**1,300**	**865**	**8,493**

4 Segmental analysis (continued)

	Lloyds Bank Group Continuing operations £m	Lloyds Bank Group Discontinued operations £m	Lloyds Bank Group Adjustments £m	Impact of other entities in the Lloyds Banking Group[1] £m	Removal of: Volatility and other items[5] £m	Removal of: Insurance gross up[3] £m	Removal of: PPI £m	Removal of: Other conduct provisions £m	Underlying basis £m
Year ended 31 December 2016									
Net interest income	11,194	(2,147)	30	197	263	1,898	–	–	11,435
Other income, net of insurance claims	3,286	3,853	(516)	1,370	121	(2,110)	–	61	6,065
Total income, net of insurance claims	14,480	1,706	(486)	1,567	384	(212)	–	61	17,500
Operating lease depreciation[4]					(895)	–	–	–	(895)
Net income	14,480	1,706	(486)	1,567	(511)	(212)	–	61	16,605
Operating expenses	(11,751)	(1,127)	486	(235)	1,948	212	1,350	1,024	(8,093)
Impairment	(752)	–	–	–	107	–	–	–	(645)
Profit before tax	1,977	579	–	1,332	1,544	–	1,350	1,085	7,867

[1] This reflects the inclusion in the results reviewed by the chief operating decision maker of the Bank's fellow subsidiary undertakings and its parent undertaking, Lloyds Banking Group plc.

[2] In the year ended 31 December 2017 this comprises the effects of asset sales (gain of £30 million); volatile items (gain of £263 million); liability management (loss of £14 million); the amortisation of purchased intangibles (£91 million); restructuring costs (£621 million, principally comprising costs relating to the Simplification programme; the rationalisation of the non-branch property portfolio, the work on implementing the ring-fencing requirements and the integration of MBNA); and the fair value unwind and other items (loss of £270 million).

[3] The Group's insurance businesses' income statements include income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact in total upon the profit attributable to equity shareholders and, in order to provide a clearer representation of the underlying trends within the business, these items are shown net within the underlying results.

[4] Net of profits on disposal of operating lease assets of £32 million (2016: £58 million).

[5] Comprises the write-off of the ECN embedded derivative and premium paid on redemption of the remaining notes in the first quarter (loss of £790 million); the effects of asset sales (gain of £217 million); volatile items (gain of £99 million); liability management (gain of £123 million); the amortisation of purchased intangibles (£340 million); restructuring costs (£622 million, principally comprising the severance related costs related to phase II of the Simplification programme); and the fair value unwind and other items (loss of £231 million).

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

5 Net interest income

	Weighted average effective interest rate 2017 %	Weighted average effective interest rate 2016 %	2017 £m	2016 £m
Interest and similar income:				
Loans and advances to customers	**3.18**	3.35	**14,554**	15,344
Loans and advances to banks	**0.41**	0.35	**253**	243
Debt securities held as loans and receivables	**1.98**	2.37	**66**	90
Interest receivable on loans and receivables	**2.84**	2.96	**14,873**	15,677
Available-for-sale financial assets	**1.96**	1.88	**980**	763
Held-to-maturity investments	**–**	1.44	**–**	231
Total interest and similar income[1]	**2.77**	2.84	**15,853**	16,671
Interest and similar expense:				
Deposits from banks, excluding liabilities under sale and repurchase agreements	**1.18**	0.69	**(80)**	(68)
Customer deposits, excluding liabilities under sale and repurchase agreements	**0.56**	0.75	**(1,937)**	(2,716)
Debt securities in issue[2]	**0.18**	0.95	**(120)**	(785)
Subordinated liabilities	**10.03**	11.49	**(1,242)**	(1,870)
Liabilities under sale and repurchase agreements	**0.54**	0.49	**(110)**	(38)
Total interest and similar expense[3]	**0.77**	1.14	**(3,489)**	(5,477)
Net interest income			**12,364**	11,194

[1] Includes £12 million (2016: £nil) of interest income on liabilities with negative interest rates.

[2] The impact of the Group's hedging arrangements is included on this line; excluding this impact the weighted average effective interest rate in respect of debt securities in issue would be 2.43 per cent (2016: 2.76 per cent).

[3] Includes £50 million (2016: £51 million) of interest expense on assets with negative interest rates.

Included within interest and similar income is £179 million (2016: £205 million) in respect of impaired financial assets. Net interest income also includes a credit of £644 million (2016: credit of £531 million) transferred from the cash flow hedging reserve (see note 36).

6 Net fee and commission income

	2017 £m	2016 £m
Fee and commission income:		
Current accounts	**712**	753
Credit and debit card fees	**949**	875
Other	**1,125**	1,216
Total fee and commission income	**2,786**	2,844
Fee and commission expense	**(1,024)**	(943)
Net fee and commission income	**1,762**	1,901

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

7 Net trading income

	2017 £m	2016 £m
Foreign exchange translation (losses) gains	**(151)**	761
Gains on foreign exchange trading transactions	**517**	535
Total foreign exchange	**366**	1,296
Investment property gains	**–**	2
Securities and other (losses) gains (see below)	**407**	(356)
Net trading income	**773**	942

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

	2017 £m	2016 £m
Net income (expense) arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**132**	85
Equity shares	**239**	263
Total net income arising on assets held at fair value through profit or loss	**371**	348
Net (expense) income arising on liabilities held at fair value through profit or loss – debt securities in issue	**(144)**	(154)
Total net gains arising on assets and liabilities held at fair value through profit or loss	**227**	194
Net (losses) gains on financial instruments held for trading	**180**	(550)
Securities and other (losses) gains	**407**	(356)

8 Other operating income

	2017 £m	2016 £m
Operating lease rental income	**1,344**	1,225
Rental income from investment properties (note 23)	**1**	3
Gains less losses on disposal of available-for-sale financial assets (note 36)	**464**	575
Liability management	**(14)**	(2,019)
Share of results of joint ventures and associates	**2**	(1)
Other income	**656**	660
Total other operating income	**2,453**	443

Liability management
In 2016 losses of £2,019 million arose on transactions undertaken as part of the Group's management of wholesale funding and capital; the loss in 2016 principally reflected transactions related to the Lloyds Banking Group's tender offers and redemptions in respect of its Enhanced Capital Notes which completed in March 2016 and a loss of £1,026 million which arose pursuant to a restructuring of the Bank's capital instruments in June 2016.

9 Operating expenses

	2017 £m	2016 £m
Staff costs:		
Salaries	**2,540**	2,609
Performance-based compensation	**464**	475
Social security costs	**343**	345
Pensions and other post-retirement benefit schemes (note 30)	**583**	525
Restructuring costs	**22**	241
Other staff costs	**466**	433
	4,418	4,628
Premises and equipment:		
Rent and rates	**364**	363
Repairs and maintenance	**231**	186
Other	**95**	118
	690	667
Other expenses:		
Communications and data processing	**880**	846
Advertising and promotion	**207**	197
Professional fees	**312**	233
Other	**701**	609
	2,100	1,885
Depreciation and amortisation:		
Depreciation of property, plant and equipment (note 23)	**1,939**	1,759
Amortisation of other intangible assets (note 22)	**353**	541
	2,292	2,300
Impairment of goodwill (note 21)	**8**	–
Total operating expenses, excluding regulatory provisions	**9,508**	9,480
Regulatory provisions		
Payment protection insurance provision (note 32)	**1,300**	1,350
Other regulatory provisions (note 32)	**822**	921
	2,122	2,271
Total operating expenses	**11,630**	11,751

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

	2017	2016
UK	**72,644**	76,914
Overseas	**794**	812
Total	**73,438**	77,726

9 Operating expenses (continued)

Fees payable to the Bank's auditors
During the year the auditors earned the following fees:

	2017 £m	2016 £m
Fees payable for the audit of the Bank's current year annual report	**3.5**	3.0
Fees payable for other services:		
Audit of the Bank's subsidiaries pursuant to legislation	**9.9**	10.6
Other services supplied pursuant to legislation	**2.3**	2.6
Other services – audit-related fees	**–**	0.1
Taxation compliance services	**–**	0.2
All other services	**1.4**	0.2
Total fees payable to the Bank's auditors	**17.1**	16.7

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

	2017 £m	2016 £m
Audits of the Group pension schemes	**0.1**	0.3
Audits of unconsolidated Open Ended Investment Companies managed by the Group	**0.3**	0.4
Reviews of the financial position of corporate and other borrowers	**–**	–
Acquisition due diligence and other work performed in respect of potential venture capital investments	**–**	1.0

10 Impairment

	2017 £m	2016 £m
Impairment losses on loans and receivables:		
Loans and advances to customers	**696**	592
Debt securities classified as loans and receivables	**(6)**	–
Total impairment losses on loans and receivables (note 18)	**690**	592
Impairment of available-for-sale financial assets	**6**	173
Other credit risk provisions	**(9)**	(13)
Total impairment charged to the income statement	**687**	752

11 Taxation

a Analysis of tax expense for the year

	2017 £m	2016 £m
UK corporation tax:		
Current tax on profit for the year	**(1,103)**	(460)
Adjustments in respect of prior years	**119**	155
	(984)	(305)
Foreign tax:		
Current tax on profit for the year	**(40)**	(20)
Adjustments in respect of prior years	**11**	2
	(29)	(18)
Current tax expense	**(1,013)**	(323)
Deferred tax (note 31):		
Current year	**(511)**	(617)
Adjustments in respect of prior years	**(78)**	(7)
	(589)	(624)
Tax expense	**(1,602)**	(947)

b Factors affecting the tax expense for the year

The UK corporation tax rate for the year was 19.25 per cent (2016: 20 per cent). An explanation of the relationship between tax expense and accounting profit is set out below:

	2017 £m	2016 £m
Profit before tax from continuing operations	**5,035**	1,977
UK corporation tax thereon	**(969)**	(395)
Impact of surcharge on banking profits	**(452)**	(266)
Non-deductible costs: conduct charges	**(287)**	(289)
Other non-deductible costs	**(50)**	(144)
Non-taxable income	**28**	147
Tax-exempt gains on disposals	**109**	18
Recognition of losses that arose in prior years	**–**	62
Remeasurement of deferred tax due to rate changes	**(21)**	(241)
Differences in overseas tax rates	**(11)**	11
Adjustments in respect of prior years	**52**	150
Tax effect of share of results of joint ventures	**(1)**	(1)
Other items	**–**	1
Tax expense on profit from continuing operations	**(1,602)**	(947)

12 Disposal group

At 31 December 2016, the Group classified the assets and liabilities of the Scottish Widows Group as a held-for-sale disposal group on the basis that a sale of its operations to its ultimate holding company, Lloyds Banking Group plc, was expected to occur within 12 months. As a result of external factors, the Group currently expects this sale to complete in 2018. Accordingly, the assets and liabilities of the Scottish Widows Group continue to be classified as a held-for-sale disposal group at 31 December 2017 and are shown separately on the face of the balance sheet. Scottish Widows represents the entirety of the Group's Insurance operations.

The Group has not recognised any impairment relating to disposal groups classified as held for sale during 2016 or 2017.

These operations have been classified as discontinued operations and the profit after tax from these activities reported as a single line on the Group's income statement.

In order to fairly reflect the results and financial position of the Group's continuing operations and its discontinued operations, transactions that the continuing operations have with the discontinued operations are reported on the relevant line in the Group's income statement or balance sheet, with the matching transaction similarly reported in the discontinued operations income statement or balance sheet within the Group's disposal group. All such transactions fully eliminate within the Group's statutory consolidation and there is no net impact on profit before tax or equity.

(1) Income statement

The results of the discontinued operations are as follows:

	2017 £ million	2016 £ million
Interest and similar income	**228**	78
Interest and similar expense	**(1,541)**	(2,225)
Net interest income	**(1,313)**	(2,147)
Fee and commission income	**373**	465
Fee and commission expense	**(553)**	(676)
Net fee and commission income	**(180)**	(211)
Net trading income (see (a) below)	**10,977**	17,590
Insurance premium income (see (b) below)	**7,930**	8,068
Other operating income	**102**	750
Other income	**18,829**	26,197
Total income	**17,516**	24,050
Insurance claims (see (c) below)	**(15,578)**	(22,344)
Total income, net of insurance claims	**1,938**	1,706
Operating expenses	**(995)**	(1,127)
Profit before tax	**943**	579
Taxation	**(147)**	(406)
Profit after tax from discontinued operations	**796**	173

(a) Net trading income

	2017 £m	2016 £m
Foreign exchange translation gains	**130**	293
Gains on foreign exchange trading transactions	**–**	7
Total foreign exchange	**130**	300
Investment property gains	**231**	(85)
Securities and other gains (see below)	**10,616**	17,375
Net trading income	**10,977**	17,590

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

	2017 £m	2016 £m
Net income arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**990**	4,714
Equity shares	**9,556**	12,269
Total net gains arising on assets held at fair value through profit or loss	**10,546**	16,983
Net gains on financial instruments held for trading	**70**	392
Securities and other gains	**10,616**	17,375

12 Disposal group (continued)

(b) Insurance premium income

	2017 £m	2016 £m
Life insurance		
Gross premiums:		
Life and pensions	6,273	5,613
Annuities	1,082	1,685
	7,355	7,298
Ceded reinsurance premiums	(168)	(88)
Net earned premiums	7,187	7,210
Non-life insurance		
Net earned premiums	743	858
Total net earned premiums	7,930	8,068

(c) Insurance claims

Insurance claims comprise:	2017 £m	2016 £m
Life insurance and participating investment contracts		
Claims and surrenders	(8,898)	(8,617)
Change in insurance and participating investment contracts	(9,067)	(14,160)
Change in non-participating investment contracts	2,836	679
	(15,129)	(22,098)
Reinsurers' share	35	106
	(15,094)	(21,992)
Change in unallocated surplus	(147)	14
Total life insurance and participating investment contracts	(15,241)	(21,978)
Non-life insurance		
Total non-life insurance claims, net of reinsurance	(337)	(366)
Total insurance claims	(15,578)	(22,344)
Life insurance and participating investment contracts gross claims and surrenders can also be analysed as follows:		
Deaths	(675)	(635)
Maturities	(1,280)	(1,347)
Surrenders	(5,674)	(5,444)
Annuities	(985)	(949)
Other	(284)	(242)
Total life insurance gross claims and surrenders	(8,898)	(8,617)

12 Disposal group (continued)

(2) Balance sheet
The assets and liabilities of the disposal group are comprised as follows:

	2017 £ million	2016 £ million
Assets		
Trading and other financial assets at fair value through profit or loss (see (a) below)	**125,051**	109,687
Derivative financial instruments	**3,465**	3,800
Loans and receivables:		
Loans and advances to banks	**2,337**	21,319
Due from fellow Lloyds Banking Group undertakings	**1,721**	2,015
	4,058	23,334
Goodwill (see (b) below)	**1,836**	1,836
Value of in-force business (see (c) below)	**4,839**	5,042
Other intangible assets	**169**	161
Property, plant and equipment (see (d) below)	**3,655**	3,678
Deferred tax assets	**1**	–
Other assets (see (e) below)	**11,153**	10,656
Total assets of disposal group	**154,227**	158,194

	2017 £ million	2016 £ million
Liabilities		
Deposits from banks	**916**	695
Due to fellow Lloyds Banking Group undertakings	**2,063**	2,386
Derivative financial instruments	**3,147**	3,008
Debt securities in issue	**1,794**	1,746
Liabilities arising from insurance contracts and participating investment contracts (see (f) below)	**103,434**	94,409
Liabilities arising from non-participating investment contracts (see (h) below)	**15,447**	20,112
Other liabilities (see (i) below)	**16,049**	24,767
Retirement benefit obligations	**77**	130
Current tax liabilities	**187**	97
Deferred tax liabilities	**823**	935
Other provisions	**236**	285
Subordinated liabilities	**2,345**	2,368
Total liabilities of disposal group	**146,518**	150,938

(a) Trading and other financial assets at fair value through profit or loss

	2017 £ million	2016 £ million
Debt securities:		
Government securities	**11,259**	13,776
Other public sector securities	**1,527**	1,324
Asset-backed securities:		
Mortgage-backed securities	**211**	660
Other asset-backed securities	**7,681**	7,813
Corporate and other debt securities	**18,194**	18,537
Total debt securities	**38,872**	42,110
Equity shares	**86,179**	67,577
Total trading and other financial assets at fair value through profit or loss	**125,051**	109,687

12 Disposal group (continued)

These comprise financial assets backing insurance contracts and investment contracts which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise. Included within these assets are investments in unconsolidated structured entities of £28,759 million (see note 17).

(b) Goodwill
Goodwill held on the balance sheet is tested at least annually for impairment. The recoverable amount of the goodwill relating to Scottish Widows has been based on a value-in-use calculation. The calculation uses pre-tax projections of future cash flows based upon budgets and plans approved by management covering a five-year period, the related run-off of existing business in force and a discount rate of 9 per cent. The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. New business cash flows beyond the five-year period have been extrapolated using a steady 2 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

(c) Value of in force business
Critical accounting estimates and judgments
The value of in-force business asset represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. The valuation of this asset requires assumptions to be made about future economic and operating conditions which are inherently uncertain and changes could significantly affect the value attributed to this asset. The methodology used to value this asset and the key assumptions that have been made in determining the carrying value of the value of in-force business asset at 31 December 2017 are set out below.

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

Economic assumptions
Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn a risk-free rate and all cash flows are discounted at a risk-free rate. The certainty equivalent approach covers all investment assets relating to insurance and participating investment contracts, other than the annuity business (where an illiquidity premium is included, see below).

A market-consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds and, since late 2012, illiquid loan assets. The value of the in-force business asset for UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of corporate bond holdings and relevant illiquid loan assets. In determining the market premium for illiquidity, a range of inputs are considered which reflect actual asset allocation and relevant observable market data. The illiquidity premium is estimated to be 114 basis points at 31 December 2017 (2016: 138 basis points).

The risk-free rate is derived from the relevant swap curve less a deduction for credit risk.

The table below shows the resulting range of yields and other key assumptions at 31 December:

	2017 %	2016 %
Risk-free rate (value of in-force non-annuity business)[1]	**0.00 to 4.20**	0.00 to 4.20
Risk-free rate (value of in-force annuity business)[1]	**1.14 to 5.34**	1.38 to 5.58
Risk-free rate (financial options and guarantees)[1]	**0.00 to 4.20**	0.00 to 4.20
Retail price inflation	**3.43**	3.50
Expense inflation	**3.67**	3.73

[1] All risk-free rates are quoted as the range of rates implied by the relevant forward swap curve.

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

Non-economic assumptions
Future mortality, morbidity, expenses, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. Further information on these assumptions is given in (e) below and the effect of changes in key assumptions is given in (f) below.

12 Disposal group (continued)

The gross value of in-force business asset is as follows:

	2017 £m	2016 £m
Acquired value of in-force non-participating investment contracts	306	340
Value of in-force insurance and participating investment contracts	4,533	4,702
Total value of in-force business	**4,839**	5,042

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

	2017 £m	2016[1] £m
At 1 January	340	377
Amortisation taken to income statement	(34)	(37)
At 31 December	**306**	340

[1] Movements during 2016 were prior to the transfer of this business into the disposal group.

The acquired value of in-force non-participating investment contracts includes £185 million (2016: £206 million) in relation to OEIC business.

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

	2017 £m	2016[1] £m
At 1 January	4,702	4,219
Exchange and other adjustments	(4)	11
Movements in the year:		
New business	348	428
Existing business:		
Expected return	(318)	(210)
Experience variances	(226)	(137)
Assumption changes	(238)	127
Economic variance	269	264
Movement in the value of in-force business taken to income statement (note 8)	(165)	472
At 31 December	**4,533**	4,702

[1] Movements during 2016 were prior to the transfer of this business into the disposal group.

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

12 Disposal group (continued)

(d) Property, plant and equipment

	Investment properties £m	Premises £m	Equipment £m	Total £m
Cost or valuation:				
At 1 January 2017	3,660	47	33	3,740
Expenditure on investment properties (see below)	187	–	–	187
Change in fair value of investment properties	231	–	–	231
Disposals	(436)	(19)	(25)	(480)
At 31 December 2017	3,642	28	8	3,678
Accumulated depreciation and impairment:				
At 1 January 2017	–	32	30	62
Depreciation charge for the year	–	1	3	4
Disposals	–	(18)	(25)	(43)
At 31 December 2017	–	15	8	23
Balance sheet amount at 31 December 2017	3,642	13	–	3,655
Balance sheet amount at 31 December 2016	3,660	15	3	3,678

Expenditure on investment properties in 2017 is comprised as follows:

	£m
Acquisitions of new properties	**60**
Additional expenditure on existing properties	**127**
	187

Rental income of £212 million (2016: £226 million) and direct operating expenses arising from properties that generate rental income of £24 million (2016: £26 million) have been recognised in the income statement.

Capital expenditure in respect of investment properties which had been contracted for but not recognised in the financial statements was £21 million (2016: £65 million).

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

(e) Other assets

	2017 £m	2016 £m
Assets arising from reinsurance contracts held	**602**	714
Deferred acquisition and origination costs	**104**	81
Corporate pension asset	**7,786**	6,645
Other assets and prepayments	**2,661**	3,216
Total other assets	**11,153**	10,656

12 Disposal group (continued)

(f) Liabilities arising from insurance contracts and participating investment contracts

Insurance contract and participating investment contract liabilities are comprised as follows:

	2017			2016		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	89,178	(563)	88,615	79,812	(671)	79,141
Participating investment contracts	13,673	–	13,673	13,984	–	13,984
	102,851	(563)	102,288	93,796	(671)	93,125
Non-life insurance contracts (see (2) below):						
Unearned premiums	358	(13)	345	404	(14)	390
Claims outstanding	225	–	225	209	–	209
	583	(13)	570	613	(14)	599
Total	103,434	(576)	102,858	94,409	(685)	93,724

[1] Reinsurance balances are reported within other assets (see (e).

(1) Life insurance

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

	Insurance contracts £m	Participating investment contracts £m	Gross £m	Reinsurance[1] £m	Net £m
At 1 January 2016[2]	66,145	13,460	79,605	(629)	78,976
New business	4,422	28	4,450	(5)	4,445
Changes in existing business	9,210	496	9,706	(37)	9,669
Change in liabilities charged to the income statement	13,632	524	14,156	(42)	14,114
Exchange and other adjustments	35	–	35	–	35
At 31 December 2016	79,812	13,984	93,796	(671)	93,125
New business	4,154	43	4,197	(21)	4,176
Changes in existing business	5,226	(354)	4,872	129	5,001
Change in liabilities charged to the income statement	9,380	(311)	9,069	108	9,177
Exchange and other adjustments	(14)	–	(14)	–	(14)
At 31 December 2017	89,178	13,673	102,851	(563)	102,288

[1] Reinsurance balances are reported within other assets (see (e).

[2] Movements in 2016 were prior to the transfer of this business into the disposal group.

Liabilities for life insurance contracts and participating investment contracts can be split into with-profit fund liabilities, accounted for using the PRA's realistic capital regime (realistic liabilities) and non-profit fund liabilities, accounted for using a prospective actuarial discounted cash flow methodology, as follows:

	2017			2016		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	8,946	80,232	89,178	9,147	70,665	79,812
Participating investment contracts	8,481	5,192	13,673	8,860	5,124	13,984
Total	17,427	85,424	102,851	18,007	75,789	93,796

With-profit fund realistic liabilities

(i) Business description

Scottish Widows Limited has the only with-profit funds within the Group. The primary purpose of the conventional and unitised business written in the with-profit funds is to provide a smoothed investment vehicle to the policyholders, protecting them against short-term market fluctuations. Payouts may be subject to a guaranteed minimum payout if certain policy conditions are met. With-profit policyholders are entitled to at least 90 per cent of the distributed profits, with the shareholders receiving the balance. The policyholders are also usually insured against death and the policy may carry a guaranteed annuity option at retirement.

12 Disposal group (continued)

(ii) Method of calculation of liabilities
With-profit liabilities are stated at their realistic value, the main components of which are:

– With-profit benefit reserve, the total asset shares for with-profit policies;
– Cost of options and guarantees (including guaranteed annuity options);
– Deductions levied against asset shares;
– Planned enhancements to with-profits benefits reserve; and
– Impact of the smoothing policy.

(iii) Assumptions
Key assumptions used in the calculation of with-profit liabilities, and the processes for determining these, are:

Investment returns and discount rates
With-profit fund liabilities are valued on a market-consistent basis, achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The with-profit fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as the spot yield derived from the relevant swap curve, adjusted for credit risk.

Guaranteed annuity option take-up rates
Certain pension contracts contain guaranteed annuity options that allow the policyholder to take an annuity benefit on retirement at annuity rates that were guaranteed at the outset of the contract. For contracts that contain such options, key assumptions in determining the cost of options are economic conditions in which the option has value, mortality rates and take-up rates of other options. The financial impact is dependent on the value of corresponding investments, interest rates and longevity at the time of the claim.

Investment volatility
The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical volatility where it is not possible to observe meaningful prices.

Mortality
The mortality assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.

Lapse rates (persistency)
Lapse rates refer to the rate of policy termination or the rate at which policyholders stop paying regular premiums due under the contract.

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

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

(iv) Options and guarantees within the With-Profit Funds
The most significant options and guarantees provided from within the With-Profit Funds are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies.

For those policies written in Scottish Widows pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up, within the With-Profit Fund originally held in Scottish Widows plc and subsequently transferred into Scottish Widows Limited, called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2017 of £2.8 billion (2016: £2.7 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, the liabilities of the With-Profit Funds are valued using a market-consistent stochastic simulation model which places a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are risk-free yield and investment volatility.

Non-profit fund liabilities
(i) Business description
The Group principally writes the following types of life insurance contracts within its non-profit funds. Shareholder profits on these types of business arise from management fees and other policy charges.

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

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

Annuities – The policyholder is entitled to payments for the duration of their life and is therefore insured against surviving longer than expected.

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

12 Disposal group (continued)

(iii) Assumptions

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

Interest rates

The rates of interest used are determined by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

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

Mortality and morbidity

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

Lapse rates (persistency)

Lapse rates are allowed for on some non-profit fund contracts. The process for setting these rates is as described for with-profit liabilities, however a prudent scenario is assumed by the inclusion of a margin for adverse deviation within the non-profit fund liabilities.

Maintenance expenses

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

Key changes in assumptions

A detailed review of the Group's assumptions in 2017 resulted in the following key impacts on profit before tax:

- Change in persistency assumptions (£237 million decrease).
- Change in the assumption in respect of current and future mortality and morbidity rates (£289 million increase).
- Change in expenses assumptions (£142 million decrease).

These amounts include the impacts of movements in liabilities and the value of in-force business in respect of insurance contracts and participating investment contracts.

(iv) Options and guarantees outside the With-Profit Funds

A number of typical guarantees are provided outside the With-Profit Funds such as guaranteed payments on death (e.g. term assurance) or guaranteed income for life (e.g. annuities). In addition, certain personal pension policyholders in Scottish Widows, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £35 million at 31 December 2017 (2016: £82 million) in respect of those guarantees.

(2) Non-life insurance

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. There has been no significant change in the assumptions and methodologies used for setting reserves.

The movements in non-life insurance contract liabilities over the year have been as follows:

	2017 £m	2016[1] £m
Provisions for unearned premiums		
Gross provision at 1 January	**404**	461
Increase in the year	**724**	827
Release in the year	**(770)**	(884)
Change in provision for unearned premiums charged to income statement	**(46)**	(57)
Gross provision at 31 December	**358**	404
Reinsurers' share	**(13)**	(14)
Net provision at 31 December	**345**	390

[1] Movements during 2016 were prior to the transfer of this business into the disposal group.

12 Disposal group (continued)

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

	2017 £m	2016[1] £m
Claims outstanding		
Gross claims outstanding at 1 January	**209**	251
Cash paid for claims settled in the year	**(321)**	(408)
Increase/(decrease) in liabilities charged to the income statement[2]	**337**	366
	16	(42)
Gross claims outstanding at 31 December	**225**	209
Reinsurers' share	**–**	–
Net claims outstanding at 31 December	**225**	209
Notified claims	**174**	122
Incurred but not reported	**51**	87
Net claims outstanding at 31 December[2]	**225**	209

[1] Movements during 2016 were prior to the transfer of this business into the disposal group.

[2] Of which an increase of £350 million (2016: £363 million) was in respect of current year claims and an increase of £13 million (2016: increase of £3 million) was in respect of prior year claims.

(g) Life insurance sensitivity analysis

Critical accounting estimates and judgments

Elements of the valuations of liabilities arising from insurance contracts and participating investment contracts require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour and are subject to significant management judgement and estimation uncertainty. The methodology used to value these liabilities and the key assumptions that have been made in determining their carrying value are set out in note (e) above.

The following table demonstrates the effect of reasonably possible changes in key assumptions on profit before tax and equity disclosed in these financial statements assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in assets, liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts. The impact is shown in one direction but can be assumed to be reasonably symmetrical.

		2017		2016	
31 December 2017	**Change in variable**	**Increase (reduction) in profit before tax £m**	**Increase (reduction) in equity £m**	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
Non-annuitant mortality[1]	5% reduction	**23**	**19**	25	21
Annuitant mortality[2]	5% reduction	**(221)**	**(184)**	(287)	(238)
Lapse rates[3]	10% reduction	**75**	**62**	48	40
Future maintenance and investment expenses[4]	10% reduction	**289**	**240**	318	264
Risk-free rate[5]	0.25% reduction	**(40)**	**(33)**	(74)	(62)
Guaranteed annuity option take-up[6]	5% addition	**(6)**	**(5)**	(12)	(10)
Equity investment volatility[7]	1% addition	**(7)**	**(6)**	(10)	(8)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	**(235)**	**(195)**	(200)	(166)
Increase in illiquidity premia[9]	0.10% addition	**145**	**120**	152	126

Assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases.

[1] This sensitivity shows the impact of reducing mortality and morbidity rates on non-annuity business to 95 per cent of the expected rate.

[2] This sensitivity shows the impact on the annuity and deferred annuity business of reducing mortality rates to 95 per cent of the expected rate.

[3] This sensitivity shows the impact of reducing lapse and surrender rates to 90 per cent of the expected rate.

[4] This sensitivity shows the impact of reducing maintenance expenses and investment expenses to 90 per cent of the expected rate.

[5] This sensitivity shows the impact on the value of in-force business, financial options and guarantee costs, statutory reserves and asset values of reducing the risk-free rate by 25 basis points.

[6] This sensitivity shows the impact of a flat 5 per cent addition to the expected rate.

[7] This sensitivity shows the impact of a flat 1 per cent addition to the expected rate.

[8] This sensitivity shows the impact of a 25 basis point increase in credit default spreads on corporate bonds and the corresponding reduction in market values. Swap curves, the risk-free rate and illiquidity premia are all assumed to be unchanged.

[9] This sensitivity shows the impact of a 10 basis point increase in the allowance for illiquidity premia. It assumes the overall spreads on assets are unchanged and hence market values are unchanged. Swap curves and the non-annuity risk-free rate are both assumed to be unchanged. The increased illiquidity premium increases the annuity risk-free rate.

12 Disposal group (continued)

(h) Liabilities arising from non-participating investment contracts

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

	2017 £m	2016[1] £m
At 1 January	**20,112**	22,777
New business	**608**	560
Changes in existing business	**(5,273)**	(3,225)
At 31 December	**15,447**	20,112

[1] Movements during 2016 were prior to the transfer of this business into the disposal group.

The balances above are shown gross of reinsurance. Related reinsurance balances were £26 million (2016: £29 million); reinsurance balances are reported within other assets (see (d)). Liabilities arising from non-participating investment contracts are categorised as level 2. See note 43 for details of levels in the fair value hierarchy.

(i) Other liabilities

	2017 £m	2016 £m
Unitholders' interest in Open Ended Investment Companies	**14,480**	22,947
Unallocated surplus within insurance businesses	**390**	243
Other creditors and accruals	**1,179**	1,577
	16,049	24,767

(j) Other comprehensive income

Cumulative other comprehensive income relating to discontinued operations was a deficit of £129 million (2016: a deficit of £184 million).

13 Trading and other financial assets at fair value through profit or loss

	The Group		The Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Trading assets	**42,830**	45,824	**42,839**	46,787
Other financial assets at fair value through profit or loss	**2,778**	5,374	**1,138**	1,522
Total	**45,608**	51,198	**43,977**	48,309

These assets are comprised as follows:

	The Group				The Bank			
	2017		2016		2017		2016	
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to customers	**30,568**	**–**	31,050	–	**30,568**	**–**	31,993	–
Loans and advances to banks	**1,614**	**–**	2,606	–	**1,614**	**–**	2,606	–
Debt securities:								
Government securities	**9,836**	**928**	11,828	1,127	**9,834**	**928**	11,828	1,127
Other public sector securities	**–**	**–**	–	–	**–**	**–**	–	–
Bank and building society certificates of deposit	**–**	**222**	–	244	**–**	**–**	–	–
Asset-backed securities:								
Mortgage-backed securities	**189**	**–**	47	–	**189**	**–**	47	–
Other asset-backed securities	**95**	**–**	69	–	**95**	**–**	69	–
Corporate and other debt securities	**528**	**1,560**	224	3,397	**539**	**210**	244	395
	10,648	**2,710**	12,168	4,768	**10,657**	**1,138**	12,188	1,522
Equity shares	**–**	**50**	–	586	**–**	**–**	–	–
Treasury bills and other bills	**–**	**18**	–	20	**–**	**–**	–	–
Total	**42,830**	**2,778**	45,824	5,374	**42,839**	**1,138**	46,787	1,522

13 Trading and other financial assets at the fair value through profit or loss (continued)

At 31 December 2017 £11,945 million (2016: £15,141 million) of trading and other financial assets at fair value through profit or loss of the Group and £11,895 million (2016: £13,151 million) of the Bank had a contractual residual maturity of greater than one year.

Other financial assets at fair value through profit or loss of the Group include private equity investments of £50 million (2016: £2,245 million) that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

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

14 Derivative financial instruments

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

	2017			2016		
The Group	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**25,736**	**1,001**	**751**	30,515	1,090	1,293
Currency swaps	**226,572**	**3,414**	**3,531**	289,161	6,903	6,486
Options purchased	**8,191**	**580**	**–**	15,192	808	–
Options written	**6,684**	**–**	**627**	17,878	–	985
	267,183	**4,995**	**4,909**	352,746	8,801	8,764
Interest rate contracts:						
Interest rate swaps	**2,254,135**	**14,566**	**14,476**	2,150,066	18,440	18,107
Forward rate agreements	**239,797**	**5**	**1**	628,962	13	87
Options purchased	**30,943**	**1,912**	**–**	38,254	2,793	–
Options written	**32,817**	**–**	**2,378**	39,847	–	3,227
Futures	**33,490**	**1**	**2**	113,557	2	–
	2,591,182	**16,484**	**16,857**	2,970,686	21,248	21,421
Credit derivatives	**4,264**	**77**	**416**	7,671	364	656
Equity and other contracts	**5,515**	**696**	**653**	7,074	734	801
Total derivative assets/liabilities held for trading	**2,868,144**	**22,252**	**22,835**	3,338,177	31,147	31,642
Hedging						
Derivatives designated as fair value hedges:						
Cross currency swaps	**1,327**	**19**	**38**	1,454	19	22
Interest rate swaps (including swap options)	**114,045**	**1,164**	**657**	195,889	1,462	1,027
Derivatives designated as cash flow hedges:						
Cross currency swaps	**7,310**	**120**	**114**	8,121	417	36
Interest rate swaps	**549,099**	**597**	**1,055**	384,182	814	1,166
Futures	**73,951**	**–**	**–**	53,115	–	3
Total derivative assets/liabilities held for hedging	**745,732**	**1,900**	**1,864**	642,761	2,712	2,254
Total recognised derivative assets/liabilities	**3,613,876**	**24,152**	**24,699**	3,980,938	33,859	33,896

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

14 Derivative financial instruments (continued)

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 46; and
- Derivatives held in policyholders funds as permitted by the investment strategies of those funds.

The principal derivatives used by the Group are as follows:

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

Hedged cash flows

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

2017	**0-1 years £m**	**1-2 years £m**	**2-3 years £m**	**3-4 years £m**	**4-5 years £m**	**5-10 years £m**	**10-20 years £m**	**Over 20 years £m**	**Total £m**
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**346**	**515**	**682**	**492**	**395**	**701**	**55**	**46**	**3,232**
Forecast payable cash flows	**(475)**	**(654)**	**(592)**	**(552)**	**(406)**	**(1,150)**	**(627)**	**(162)**	**(4,618)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**307**	**562**	**648**	**448**	**466**	**684**	**63**	**54**	**3,232**
Forecast payable cash flows	**(680)**	**(640)**	**(556)**	**(505)**	**(377)**	**(1,085)**	**(612)**	**(163)**	**(4,618)**

2016	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	172	198	415	372	391	1,215	102	45	2,910
Forecast payable cash flows	(565)	(722)	(692)	(599)	(429)	(1,541)	(806)	(262)	(5,616)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	211	223	418	363	472	1,070	99	54	2,910
Forecast payable cash flows	(777)	(713)	(671)	(521)	(415)	(1,477)	(787)	(255)	(5,616)

There were no transactions for which cash flow hedge accounting had to be ceased in 2016 or 2017 as a result of the highly probable cash flows no longer being expected to occur.

At 31 December 2017 £21,654 million of total recognised derivative assets of the Group and £20,505 million of total recognised derivative liabilities of the Group (2016: £28,744 million of assets and £29,062 million of liabilities) had a contractual residual maturity of greater than one year.

14 Derivative financial instruments (continued)

The Bank	2017 Contract/ notional amount £m	2017 Fair value assets £m	2017 Fair value liabilities £m	2016 Contract/ notional amount £m	2016 Fair value assets £m	2016 Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**28,399**	**916**	**809**	28,541	1,228	1,282
Currency swaps	**255,181**	**3,908**	**3,964**	306,726	7,438	7,160
Options purchased	**8,090**	**574**	**–**	15,073	800	–
Options written	**6,560**	**–**	**625**	17,717	–	979
	298,230	**5,398**	**5,398**	368,057	9,466	9,421
Interest rate contracts:						
Interest rate swaps	**2,822,741**	**18,294**	**17,787**	2,364,053	22,736	22,198
Forward rate agreements	**242,787**	**6**	**2**	634,121	14	88
Options purchased	**30,496**	**1,827**	**–**	39,297	2,665	–
Options written	**31,952**	**11**	**2,245**	39,711	12	2,989
Futures	**92,196**	**1**	**2**	107,599	2	–
	3,220,172	**20,139**	**20,036**	3,184,781	25,429	25,275
Credit derivatives	**5,801**	**118**	**443**	8,123	378	664
Equity and other contracts	**5,541**	**335**	**311**	7,422	369	471
Total derivative assets/liabilities held for trading	**3,529,744**	**25,990**	**26,188**	3,568,383	35,642	35,831
Hedging						
Derivatives designated as fair value hedges:						
Cross currency swaps	**1,327**	**19**	**38**	1,442	19	22
Interest rate swaps (including swap options)	**120,076**	**712**	**2,008**	204,068	938	2,695
Derivatives designated as cash flow hedges:						
Currency swaps	**–**	**–**	**–**	8,121	–	–
Interest rate swaps	**127,228**	**43**	**33**	381,662	115	40
Futures	**14,985**	**–**	**–**	50,299	–	3
Total derivative assets/liabilities held for hedging	**263,616**	**774**	**2,079**	645,592	1,072	2,760
Total recognised derivative assets/liabilities	**3,793,360**	**26,764**	**28,267**	4,213,975	36,714	38,591

14 Derivative financial instruments (continued)

Hedged cash flows

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

2017	**0-1 years £m**	**1-2 years £m**	**2-3 years £m**	**3-4 years £m**	**4-5 years £m**	**5-10 years £m**	**10-20 years £m**	**Over 20 years £m**	**Total £m**
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**65**	**173**	**253**	**181**	**253**	**490**	**22**	**5**	**1,442**
Forecast payable cash flows	**(31)**	**(20)**	**(10)**	**(3)**	**(1)**	**–**	**(16)**	**(41)**	**(122)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**65**	**173**	**253**	**181**	**253**	**490**	**22**	**5**	**1,442**
Forecast payable cash flows	**(31)**	**(20)**	**(10)**	**(3)**	**(1)**	**–**	**(16)**	**(41)**	**(122)**

2016	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	96	49	210	158	189	813	33	7	1,555
Forecast payable cash flows	(79)	(69)	(23)	(11)	(3)	(1)	(15)	(42)	(243)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	145	66	231	152	239	690	26	6	1,555
Forecast payable cash flows	(103)	(48)	(22)	(9)	(3)	–	(16)	(42)	(243)

There were no transactions for which cash flow hedge accounting had to be ceased in 2016 or 2017 as a result of the highly probable cash flows no longer being expected to occur.

At 31 December 2017 £24,005 million of total recognised derivative assets of the Bank and £24,883 million of total recognised derivative liabilities of the Bank (2016: £31,616 million of assets and £33,390 million of liabilities) had a contractual residual maturity of greater than one year.

15 Loans and advances to customers

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Agriculture, forestry and fishing	**7,074**	6,860	**2,996**	3,018
Energy and water supply	**1,609**	2,320	**1,383**	2,037
Manufacturing	**7,886**	7,285	**7,389**	6,556
Construction	**4,428**	4,535	**3,068**	2,859
Transport, distribution and hotels	**14,074**	13,320	**10,484**	10,041
Postal and telecommunications	**2,148**	2,564	**1,677**	2,009
Property companies	**27,606**	29,243	**22,273**	22,266
Financial, business and other services	**54,003**	46,077	**45,550**	36,677
Personal:				
Mortgages	**304,480**	306,484	**57,889**	55,489
Other	**28,757**	20,761	**9,908**	9,939
Lease financing	**2,094**	2,628	**404**	571
Hire purchase	**13,591**	11,617	**8,894**	10,735
Total loans and advances to customers before allowance for impairment losses	**467,750**	453,694	**171,915**	162,197
Allowance for impairment losses (note 18)	**(2,195)**	(2,412)	**(1,111)**	(1,036)
Total loans and advances to customers	**465,555**	451,282	**170,804**	161,161

At 31 December 2017 £385,394 million (2016: £383,165 million) of loans and advances to customers of the Group and £116,630 million (2016: £116,962 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 46.

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Gross investment in finance leases, receivable:				
Not later than 1 year	**680**	551	**129**	130
Later than 1 year and not later than 5 years	**1,106**	1,618	**218**	391
Later than 5 years	**1,053**	1,561	**142**	166
	2,839	3,730	**489**	687
Unearned future finance income on finance leases	**(692)**	(1,038)	**(68)**	(99)
Rentals received in advance	**(53)**	(64)	**(17)**	(17)
Net investment in finance leases	**2,094**	2,628	**404**	571

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Not later than 1 year	**546**	361	**117**	112
Later than 1 year and not later than 5 years	**887**	1,282	**197**	357
Later than 5 years	**661**	985	**90**	102
Net investment in finance leases	**2,094**	2,628	**404**	571

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2016 and 2017 no contingent rentals in respect of finance leases were recognised in the income statement. There was no allowance for uncollectable finance lease receivables included in the allowance for impairment losses for the Group (2016: £nil).

16 Securitisations and covered bonds

Securitisation programmes

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

Covered bond programmes

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

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

	2017		2016	
	Loans and advances securitised £m	**Notes in issue £m**	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes[1]				
UK residential mortgages	**21,158**	**14,105**	35,146	17,705
Commercial loans	**6,616**	**7,001**	7,395	8,179
Credit card receivables	**7,701**	**4,090**	7,610	5,723
Dutch residential mortgages	**–**	**–**	2,033	2,081
	35,475	**25,196**	52,184	33,688
Less held by the Group		**(21,466)**		(25,751)
Total securitisation programmes (note 28)		**3,730**		7,937
Covered bond programmes				
Residential mortgage-backed	**30,361**	**25,632**	33,881	30,021
Social housing loan-backed	**1,628**	**1,200**	2,087	1,200
	31,989	**26,832**	35,968	31,221
Less held by the Group		**(700)**		(700)
Total covered bond programmes (note 28)		**26,132**		30,521
Total securitisation and covered bond programmes		**29,862**		38,458

[1] Includes securitisations utilising a combination of external funding and credit default swaps.

Cash deposits of £3,507 million (2016: £9,018 million) which support the debt securities issued by the structured entities, the term advances related to covered bonds and other legal obligations are held by the Group. Additionally, the Group had certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2017 these obligations had not been triggered and the maximum exposure under these facilities was £95 million (2016: £328 million).

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

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

The Group has not voluntarily offered to repurchase assets from any of its public securitisation programmes during 2017 (2016: none).

17 Structured entities

The Group's interests in structured entities are both consolidated and unconsolidated. Detail of the Group's interests in consolidated structured entities are set out in: note 16 for securitisations and covered bond vehicles, note 30 for structured entities associated with the Group's pension schemes, and below in parts (A) and (B); the consolidated vehicles and partnerships discussed in part (B) are within the disposal group (see note 12). Details of the Group's interests in unconsolidated structured entities are included below in part (C).

(A) Asset-backed conduits

In addition to the structured entities discussed in note 16, which are used for securitisation and covered bond programmes, the Group sponsors an active asset-backed conduit, Cancara, which invests in client receivables and debt securities. The total consolidated exposure of Cancara at 31 December 2017 was £6,049 million (2016: £6,840 million), comprising £5,939 million of loans and advances (2016: £6,684 million) and £110 million of debt securities (2016: £156 million).

All lending assets and debt securities held by the Group in Cancara are restricted in use, as they are held by the collateral agent for the benefit of the commercial paper investors and the liquidity providers only. The Group provides liquidity facilities to Cancara under terms that are usual and customary for standard lending activities in the normal course of the Group's banking activities. During 2017 there have continued to be planned drawdowns on certain liquidity facilities for balance sheet management purposes, supporting the programme to provide funding alongside the proceeds of the asset-backed commercial paper issuance. The Group could be asked to provide support under the contractual terms of these arrangements including, for example, if Cancara experienced a shortfall in external funding, which may occur in the event of market disruption.

The external assets in Cancara are consolidated in the Group's financial statements.

(B) Consolidated collective investment vehicles and limited partnerships

The assets of the Insurance business held in consolidated collective investment vehicles, such as Open-Ended Investment Companies and limited partnerships, are not directly available for use by the Group. However, the Group's investment in the majority of these collective investment vehicles is readily realisable. As at 31 December 2017, the total carrying value of these consolidated collective investment vehicle assets and liabilities held by the Group was £68,124 million (2016: £75,669 million).

The Group has no contractual arrangements (such as liquidity facilities) that would require it to provide financial or other support to the consolidated collective investment vehicles; the Group has not previously provided such support and has no current intentions to provide such support.

(C) Unconsolidated collective investment vehicles and limited partnerships

The Group's direct interests in unconsolidated structured entities comprise investments in collective investment vehicles, such as Open-Ended Investment Companies, and limited partnerships with a total carrying value of £28,759 million at 31 December 2017 (2016: £15,611 million), included within financial assets designated at fair value through profit and loss in the disposal group (see note 12). These investments include both those entities managed by third parties and those managed by the Group. At 31 December 2017, the total asset value of these unconsolidated structured entities, including the portion in which the Group has no interest, was £2,338 billion (2016: £1,849 billion).

The Group's maximum exposure to loss is equal to the carrying value of the investment. However, the Group's investments in these entities are primarily held to match policyholder liabilities in the Insurance division and the majority of the risk from a change in the value of the Group's investment is matched by a change in policyholder liabilities. The collective investment vehicles are primarily financed by investments from investors in the vehicles.

During the year the Group has not provided any non-contractual financial or other support to these entities and has no current intention of providing any financial or other support. There were no transfers from/to these unconsolidated collective investment vehicles and limited partnerships.

The Group considers itself the sponsor of a structured entity where it is primarily involved in the design and establishment of the structured entity; and further where the Group transfers assets to the structured entity; market products associated with the structured entity in its own name and/or provide guarantees regarding the structured entity's performance.

The Group sponsors a range of diverse investment funds and limited partnerships where it acts as the fund manager or equivalent decision maker and markets the funds under one of the Group's brands.

The Group earns fees from managing the investments of these funds. The investment management fees that the Group earned from these entities, including those in which the Group held no ownership interest at 31 December 2017, are reported within discontinued operations (see note 12).

18 Allowance for impairment losses on loans and receivables

Critical accounting estimates and judgments

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

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

For such individually identified financial assets, a review is undertaken of the expected future cash flows which requires significant management judgement as to the amount and timing of such cash flows. Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of costs to realise, whether or not foreclosure or realisation of the collateral is probable. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer, and the value of the security held, for which there may not be a readily accessible market. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

Collective impairment allowances are generally established for smaller balance homogenous portfolios such as the retail portfolios. For these portfolios the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors such as the type of asset, industry sector, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

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

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

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience. The collective impairment allowance is also subject to estimation uncertainty and in particular is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is, however, inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

The value of collateral supporting the Group's UK mortgage portfolio is estimated by applying changes in the house price indices to the original assessed value of the property. Given the relative size of the portfolio, this is a key variable in determining the Group's impairment charge for loans and receivables. If average house prices were ten per cent lower than those estimated at 31 December 2017, the impairment charge would increase by approximately £200 million in respect of UK mortgages.

In addition, the collective provision also includes provision for losses that have been incurred but have not been separately identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. Risk drivers for secured retail lending include the current indexed loan-to-value, previous mortgage arrears, internal cross-product delinquency data and external credit bureau data; for unsecured retail lending they include whether the account is up-to-date and, if not, the number of payments that have been missed; and for commercial lending they include factors such as observed default rates and loss given default. An assessment is made of the likelihood of assets being impaired at the balance sheet date and being identified subsequently; the length of time taken to identify that an impairment event has occurred is known as the loss emergence period. The loss emergence period is determined by local management for each portfolio and the Group has a range of loss emergence periods which are dependent upon the characteristics of the portfolios. Loss emergence periods are reviewed regularly and updated when appropriate. In general the periods used across the Group vary between one month and twelve months based on historical experience. Unsecured portfolios tend to have shorter loss emergence periods than secured portfolios. This provision is sensitive to changes in the loss emergence period. Management use a significant level of judgement when determining the collective unidentified impairment provision, including the assessment of the level of overall risk existing within particular sectors and the impact of the low interest rate environment on loss emergence periods. In the Commercial Banking division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unidentified impairment provisions would result in an increase in the collective unidentified impairment provision of approximately £25 million (2016: £33 million).

18 Allowance for impairment losses on loans and receivables (continued)

The Group	2017 Loans and advances to customers £m	2017 Debt securities £m	2017 Total £m	2016 Loans and advances to customers £m	2016 Debt securities £m	2016 Total £m
At 1 January	**2,412**	**76**	**2,488**	3,033	97	3,130
Exchange and other adjustments	**127**	**(23)**	**104**	69	–	69
Advances written off	**(1,499)**	**(44)**	**(1,543)**	(2,111)	(22)	(2,133)
Recoveries of advances written off in previous years	**482**	**–**	**482**	861	1	862
Unwinding of discount	**(23)**	**–**	**(23)**	(32)	–	(32)
Charge to the income statement (note 10)	**696**	**(6)**	**690**	592	–	592
At 31 December	**2,195**	**3**	**2,198**	2,412	76	2,488

Of the Group's total allowance in respect of loans and advances to customers, £1,767 million (2016: £1,876 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the Group's total allowance in respect of loans and advances to customers, £1,201 million (2016: £1,208 million) was assessed on a collective basis.

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

The Bank – loans and advances to customers	2017 £m	2016 £m
At 1 January	**1,036**	1,223
Exchange and other adjustments	**122**	15
Advances written off	**(645)**	(973)
Recoveries of advances written off in previous years	**170**	365
Unwinding of discount	**(37)**	(44)
Charge to the income statement	**465**	450
At 31 December	**1,111**	1,036

Of the Bank's total allowance in respect of loans and advances to customers, £846 million (2016: £774 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the Bank's total allowance in respect of loans and advances to customers, £556 million (2016: £527 million) was assessed on a collective basis.

19 Available-for-sale financial assets

The Group	2017 £m	2016 £m
Debt securities:		
Government securities	34,708	48,714
Bank and building society certificates of deposit	167	142
Asset-backed securities:		
Mortgage-backed securities	1,156	108
Other asset-backed securities	255	317
Corporate and other debt securities	4,615	6,030
	40,901	55,311
Equity shares	816	1,213
Total available-for-sale financial assets	**41,717**	56,524

The Bank	2017 £m	2016 £m
Debt securities:		
Government securities	34,571	48,576
Bank and building society certificates of deposit	167	142
Asset-backed securities:		
Mortgage-backed securities	1,129	71
Other asset-backed securities	65	127
Corporate and other debt securities	5,871	5,475
	41,803	54,391
Equity shares	763	731
Total available-for-sale financial assets	**42,566**	55,122

At 31 December 2017 £39,717 million (2016: £55,204 million) of available-for-sale financial assets of the Group and £38,937 million (2016: £52,302 million) of the Bank had a contractual residual maturity of greater than one year.

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

20 Acquisition of MBNA Limited

On 1 June 2017, following the receipt of competition and regulatory approval, the Group acquired 100 per cent of the ordinary share capital of MBNA Limited (MBNA), which together with its subsidiaries undertakes a UK consumer credit card business, from FIA Jersey Holdings Limited, a wholly-owned subsidiary of Bank of America. The acquisition will enable the Group to enhance its position and offering within the UK prime credit card market. The total fair value of the purchase consideration was £2,016 million, settled in cash. The acquisition is expected to result in a significant opportunity for cost synergies and goodwill of £302 million has been recognised on the transaction. None of the goodwill recognised is deductible for tax purposes.

The table below sets out the fair value of the identifiable assets and liabilities acquired. The Group has finalised the acquisition accounting in the second half of 2017 and this has resulted in a reduction in other assets of £23 million, an increase in deferred tax assets of £4 million and an increase in goodwill of £19 million compared to the provisional amounts previously reported.

	Book value as at 1 June 2017 £m	Fair value adjustments £m	Fair value as at 1 June 2017 £m
Assets			
Loans and advances to customers	7,466	345	7,811
Available-for-sale financial assets	16	–	16
Purchased credit card relationships	–	702	702
Deferred tax assets	27	4	31
Other assets	190	322	512
Total assets	7,699	1,373	9,072
Liabilities			
Deposits from banks[1]	6,431	–	6,431
Deferred tax liabilities	3	184	187
Other liabilities	112	–	112
Other provisions	233	395	628
Total liabilities	6,779	579	7,358
Fair value of net assets acquired	920	794	1,714
Goodwill arising on acquisition			302
Total consideration			2,016

[1] Upon acquisition, the funding of MBNA was assumed by the Bank.

At acquisition date, the contractual amount of loans and advances receivable from customers was £7,628 million. The amount expected to be collected is not materially different from the book value recognised by MBNA at 1 June 2017 (£7,466 million).

As a result of an indemnity guaranteed by Bank of America, N.A., the Group's exposure to MBNA's PPI liability is capped at £240 million. Acquisition-related costs of £21 million have been included in operating expenses for the year ended 31 December 2017.

The post-acquisition total income of MBNA, which is included in the Group statutory consolidated income statement for the year ended 31 December 2017, is £436 million. MBNA also contributed profit before tax of £146 million for the same period.

Had the acquisition date of MBNA been 1 January 2017, the Group's consolidated total income from continuing operations would have been £329 million higher at £17,681 million and the Group's consolidated profit before tax from continuing operations would have been £112 million higher at £5,147 million.

21 Goodwill of the Group

	2017 £m	2016 £m
At 1 January	180	2,016
Acquisition of businesses (note 20)	302	–
Impairment charged to the income statement (note 9)	(8)	–
Transfer to disposal group (note 12)	–	(1,836)
At 31 December	474	180
Cost[1]	828	526
Accumulated impairment losses	(354)	(346)
At 31 December	474	180

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

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £474 million (2016: £180 million), £302 million, or 64 per cent of the total (2016: £nil) relates to the acquisition of MBNA (note 20) and has been allocated to Cards and £170 million, or 36 per cent of the total (2016: £170 million, 94 per cent of the total) has been allocated to Motor Finance, both in the Group's Retail division.

21 Goodwill of the Group (continued)

The recoverable amount of the goodwill relating to Motor Finance has also been based on a value in use calculation using pre-tax cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 14 per cent. The cash flows beyond the five-year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Motor Finance participates. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of Motor Finance to fall below its balance sheet carrying value.

The goodwill relating to the acquisition of MBNA has been allocated to the Group's Cards business as the Cards business is expected to benefit from the synergies of the acquisition. The recoverable amount of this goodwill has been based on a value-in-use calculation using pre-tax cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 14 per cent. The cash flows beyond the five year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Cards participates. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of the Cards business to fall below the balance sheet carrying value.

22 Other intangible assets

	The Group						The Bank
	Brands £m	**Core deposit intangibles £m**	**Purchased credit card relation-ships £m**	**Customer related intangibles £m**	**Capitalised software enhance-ments £m**	**Total £m**	**Capitalised software enhance-ments £m**
Cost:							
At 1 January 2016	596	2,770	315	538	1,814	6,033	1,246
Additions	–	–	–	–	463	463	338
Disposals	–	–	–	–	(110)	(110)	(1)
Transfer to disposal group (see note12)	–	–	–	(67)	(286)	(353)	–
At 31 December 2016	596	2,770	315	471	1,881	6,033	1,583
Acquisition of businesses (note 20)	**–**	**–**	**702**	**–**	**–**	**702**	**–**
Additions	**–**	**–**	**–**	**–**	**804**	**804**	**749**
Disposals	**–**	**–**	**–**	**–**	**(24)**	**(24)**	**(1)**
At 31 December 2017	**596**	**2,770**	**1,017**	**471**	**2,661**	**7,515**	**2,331**
Accumulated amortisation:							
At 1 January 2016	149	2,460	309	472	805	4,195	526
Charge for the year[1]	22	297	2	27	234	582	164
Disposals	–	–	–	–	(72)	(72)	–
Transfer to disposal group (see note12)	–	–	–	(66)	(126)	(192)	–
At 31 December 2016	171	2,757	311	433	841	4,513	690
Charge for the year (note 9)	**22**	**13**	**44**	**19**	**255**	**353**	**226**
Disposals	**–**	**–**	**–**	**–**	**(17)**	**(17)**	**–**
At 31 December 2017	**193**	**2,770**	**355**	**452**	**1,079**	**4,849**	**916**
Balance sheet amount at 31 December 2017	**403**	**–**	**662**	**19**	**1,582**	**2,666**	**1,415**
Balance sheet amount at 31 December 2016	425	13	4	38	1,040	1,520	893

[1] In the year ended 31 December 2016 a charge of £541 million arose in the Group's continuing operations (note 9) and a charge of £41 million in its discontinued operations (note 12).

Included within brands above are assets of £380 million (2016: £380 million) that have been determined to have indefinite useful lives and are not amortised. These brands use the Bank of Scotland name which has been in existence for over 300 years. These brands are well established financial services brands and there are no indications that they should not have an indefinite useful life.

The additional £702 million of purchased credit card relationships in the year ended 31 December 2017 have arisen from the acquisition of MBNA (see note 20) and represent the benefit of recurring income generated from the portfolio of credit cards purchased.

23 Property, plant and equipment

	The Group					The Bank			
	Investment properties £m	Premises £m	Equipment £m	Operating lease assets £m	Total £m	Premises £m	Equipment £m	Operating lease assets £m	Total £m
Cost or valuation:									
At 1 January 2016	4,361	2,589	5,266	5,023	17,239	1,693	5,248	178	7,119
Exchange and other adjustments	13	2	6	112	133	–	1	37	38
Additions	–	59	806	2,088	2,953	29	755	–	784
Expenditure on investment properties (see below)	344	–	–	–	344	–	–	–	–
Change in fair value of investment properties[1]	(83)	–	–	–	(83)	–	–	–	–
Disposals	(871)	(100)	(113)	(1,017)	(2,101)	(47)	(82)	–	(129)
Transfer to disposal group (note 12)	(3,660)	(47)	(33)	–	(3,740)	–	–	–	–
At 31 December 2016	104	2,503	5,932	6,206	14,745	1,675	5,922	215	7,812
Exchange and other adjustments	**(9)**	**(37)**	**(5)**	**(44)**	**(95)**	**70**	**1**	**(18)**	**53**
Acquisition of businesses (note 20)	**–**	**3**	**3**	**–**	**6**	**–**	**–**	**–**	**–**
Additions	**–**	**70**	**382**	**2,262**	**2,714**	**46**	**361**	**–**	**407**
Expenditure on investment properties (see below)	**23**	**–**	**–**	**–**	**23**	**–**	**–**	**–**	**–**
Disposals	**(68)**	**(776)**	**(1,257)**	**(1,896)**	**(3,997)**	**(165)**	**(112)**	**(67)**	**(344)**
At 31 December 2017	**50**	**1,763**	**5,055**	**6,528**	**13,396**	**1,626**	**6,172**	**130**	**7,928**
Accumulated depreciation and impairment:									
At 1 January 2016	–	1,247	2,096	917	4,260	1,012	2,566	19	3,597
Exchange and other adjustments	–	(1)	(8)	49	40	–	1	5	6
Depreciation charge for the year[2]	–	136	672	953	1,761	68	583	6	657
Disposals	–	(49)	(89)	(410)	(548)	(32)	(60)	–	(92)
Transfer to disposal group (note 12)	–	(32)	(30)	–	(62)	–	–	–	–
At 31 December 2016	–	1,301	2,641	1,509	5,451	1,048	3,090	30	4,168
Exchange and other adjustments	**–**	**(8)**	**(10)**	**(34)**	**(52)**	**66**	**5**	**(15)**	**56**
Depreciation charge for the year (note 9)	**–**	**122**	**732**	**1,085**	**1,939**	**63**	**644**	**6**	**713**
Disposals	**–**	**(704)**	**(1,246)**	**(1,054)**	**(3,004)**	**(154)**	**(107)**	**–**	**(261)**
At 31 December 2017	**–**	**711**	**2,117**	**1,506**	**4,334**	**1,023**	**3,632**	**21**	**4,676**
Balance sheet amount at 31 December 2017	**50**	**1,052**	**2,938**	**5,022**	**9,062**	**603**	**2,540**	**109**	**3,252**
Balance sheet amount at 31 December 2016	104	1,202	3,291	4,697	9,294	627	2,832	185	3,644

[1] In the year ended 31 December 2016 gains of £2 million were recognised in the Group's continuing operations (note 7) and losses of £85 million in its discontinued operations (note 12).

[2] In the year ended 31 December 2016 a charge of £1,759 million arose in the Group's continuing operations (note 9) and a charge of £2 million arose in its discontinued operations (note 12).

Expenditure on investment properties is comprised as follows:

	2017 £m	2016 £m
Acquisitions of new properties	**23**	251
Additional expenditure on existing properties	**–**	93
	23	344

Rental income of £1 million (2016: £3 million) and direct operating expenses arising from properties that generate rental income of £nil million (2016: £nil) have been recognised in the income statement.

Capital expenditure in respect of investment properties which had been contracted for but not recognised in the financial statements was £nil (2016: £nil).

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

23 Property, plant and equipment (continued)

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

	2017 £m	2016 £m
Receivable within 1 year	**1,301**	1,120
1 to 5 years	**1,419**	1,373
Over 5 years	**128**	347
Total future minimum rentals receivable	**2,848**	2,840

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2016 and 2017 no contingent rentals in respect of operating leases were recognised in the income statement.

Total future minimum sub-lease income of £49 million for the Group and £24 million for the Bank at 31 December 2017 (£82 million for the Group and £26 million for the Bank at 31 December 2016) is expected to be received under non-cancellable sub-leases of premises.

24 Investment in subsidiary undertakings of the Bank

	2017 £m	2016 £m
At 1 January	**31,135**	39,241
Additional capital injections and transfers	**2,362**	310
Disposals	**(317)**	(231)
Adjustment on vesting of businesses (see below)	**(127)**	–
Impairment	**(175)**	(563)
Investment held for sale[1]	**–**	(7,622)
At 31 December	**32,878**	31,135

[1] The investment held for sale is shown separately on the face of the balance sheet.

Details of the subsidiaries and related undertakings are given on pages 146 to 154 and are incorporated by reference.

On 1 October 2017, pursuant to a Banking Business Transfer Scheme under Part VII of the Financial Services and Markets Act 2000 approved by the Court on 12 September 2017, the business and the majority of the assets and liabilities of two of the Bank's subsidiaries, Lloyds Bank Private Banking Limited and Scottish Widows Bank plc, were transferred to the Bank. This gave rise to a credit of £278 million directly in the Bank's equity, being equal to the net assets transferred less the carrying value of the Bank's investment in the two subsidiaries.

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

25 Other assets

	The Group		The Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Settlement balances	**556**	533	**513**	416
Investments in joint ventures and associates	**9**	59	**5**	5
Other assets and prepayments	**1,779**	1,549	**599**	747
Total other assets	**2,344**	2,141	**1,117**	1,168

26 Customer deposits

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Non-interest bearing current accounts	**70,444**	61,804	**50,094**	42,478
Interest bearing current accounts	**95,889**	90,978	**55,260**	55,509
Savings and investment accounts	**196,966**	208,227	**95,035**	74,946
Liabilities in respect of securities sold under repurchase agreements	**2,638**	2,462	**2,637**	2,462
Other customer deposits	**52,187**	51,989	**31,371**	37,740
Total customer deposits	**418,124**	415,460	**234,397**	213,135

At 31 December 2017 £11,312 million (2016: £20,851 million) of customer deposits of the Group and £1,319 million (2016: £3,942 million) of the Bank had a contractual residual maturity of greater than one year.

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

Included in the amounts above for the Group are deposits of £220,855 million (2016: £219,106 million) which are protected under the UK Financial Services Compensation Scheme.

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Liabilities held at fair value through profit or loss	**7,812**	9,425	**7,812**	9,423
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**41,378**	42,067	**41,378**	43,011
Other deposits	**381**	530	**552**	860
Short positions in securities	**1,303**	2,482	**1,303**	2,482
	43,062	45,079	**43,233**	46,353
Trading and other financial liabilities at fair value through profit or loss	**50,874**	54,504	**51,045**	55,776

At 31 December 2017, the Group had £9,022 million (2016: £10,133 million) and the Bank had £8,837 million (2016: £10,182 million) of trading and other liabilities at fair value through profit or loss with a contractual residual maturity of greater than one year.

Liabilities designated at fair value through profit or loss primarily represent debt securities in issue which either contain substantive embedded derivatives which would otherwise need to be recognised and measured at fair value separately from the related debt securities, or which are accounted for at fair value to significantly reduce an accounting mismatch.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2017 was £14,224 million (2016: £16,079 million), which was £6,412 million higher than the balance sheet carrying value (2016: £6,656 million higher). At 31 December 2017 there was a cumulative £147 million increase (2016: £95 million increase) in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of the Bank. Of the cumulative amount, an increase of £52 million arose in 2017 and an increase of £28 million arose in 2016.

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

28 Debt securities in issue

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Medium-term notes issued	**18,763**	24,867	**17,663**	23,571
Covered bonds (note 16)	**26,132**	30,521	**36,950**	41,037
Certificates of deposit issued	**9,999**	8,127	**9,999**	8,126
Securitisation notes (note 16)	**3,730**	7,937	**779**	501
Commercial paper	**3,241**	3,281	**858**	1,131
Total debt securities in issue	**61,865**	74,733	**66,249**	74,366

At 31 December 2017 £41,749 million (2016: £49,888 million) of debt securities in issue of the Group and £48,187 million (2016: £54,985 million) of the Bank had a contractual residual maturity of greater than one year.

29 Other liabilities

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Settlement balances	**331**	346	**316**	252
Other creditors and accruals	**4,209**	4,386	**3,109**	3,043
	4,540	4,732	**3,425**	3,295

30 Retirement benefit obligations

	2017 £m	2016 £m
Charge to the Group income statement		
Defined benefit pension schemes	**334**	263
Other post-retirement benefit schemes	**7**	8
Total defined benefit schemes	**341**	271
Defined contribution pension schemes	**242**	254
Total charge to the income statement – continuing operations (note 9)	**583**	525

In addition, there was a charge of £42 million (2016: £30 million) within discontinued operations (see note 12).

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Amounts recognised in the balance sheet				
Retirement benefit assets	**723**	342	**673**	254
Retirement benefit obligations	**(281)**	(692)	**(143)**	(399)
Total amounts recognised in the balance sheet	**442**	(350)	**530**	(145)

The total amount recognised in the balance sheet relates to:

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Defined benefit pension schemes	**586**	(114)	**633**	(23)
Other post-retirement benefit schemes	**(144)**	(236)	**(103)**	(122)
Total amounts recognised in the balance sheet	**442**	(350)	**530**	(145)

30 Retirement benefit obligations (continued)

Pension schemes

Defined benefit schemes

Critical accounting estimates and judgments

The accounting valuation of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds in the currency and with a term consistent with the defined benefit pension schemes' obligations. The average duration of the schemes' obligations is approximately 19 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate. The cost of the benefits payable by the schemes will also depend upon the life expectancy of the members. The Group considers latest market practice and actual experience in determining the appropriate assumptions for both current mortality expectations and the rate of future mortality improvement. It is uncertain whether this rate of improvement will be sustained going forward and, as a result, actual experience may differ from current expectations. The effect on the net accounting surplus or deficit and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions is set out in (iii) below.

(i) Characteristics of and risks associated with the Group's schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas. All significant schemes are based in the UK, with the three most significant being the defined benefit sections of the Lloyds Bank Pension Schemes No's 1 and 2 and the HBOS Final Salary Pension Scheme. At 31 December 2017, these schemes represented 97 per cent of the Group's total gross defined benefit pension assets (2016: 97 per cent). These schemes provide retirement benefits calculated as a percentage of final pensionable salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2017 is generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The Group operates a number of funded and unfunded pension arrangements, the majority, including the three most significant schemes, are funded schemes in the UK. All these schemes are operated as separate legal entities under trust law by the trustees and are in compliance with the Pensions Act 2004. The responsibility for the governance of the Group's funded defined benefit pension schemes lies with the Pension Trustees. All of the Group's funded UK defined benefit pension schemes are managed by a Trustee Board (the Trustee) whose role is to ensure that their Scheme is administered in accordance with the Scheme rules and relevant legislation, and to safeguard the assets in the best interests of all members and beneficiaries. The Trustee is solely responsible for setting investment policy and for agreeing funding requirements with the employer through the funding valuation process. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

A valuation to determine the funding status of each scheme is carried out at least every three years, whereby scheme assets are measured at market value and liabilities (technical provisions) are measured using prudent assumptions. If a deficit is identified a recovery plan is agreed between the Group and the scheme Trustee and sent to the Pensions Regulator for review. The Group has not provided for these deficit contributions as the future economic benefits arising from these contributions are expected to be available to the Group. The Group's overseas defined benefit pension schemes are subject to local regulatory arrangements.

The most recent triennial funding valuation of the Group's three main schemes, based on the position as at 31 December 2016, is substantially complete and the terms have been agreed in principle with the trustees. The valuation shows an aggregate funding deficit of £7.3 billion (a funding level of 85.6 per cent) compared to a £5.2 billion deficit (a funding level of 85.9 per cent) for the previous valuation as at 30 June 2014. In the light of this funding deficit, and in contemplation of the changes the Group expects to make as a result of its Structural Reform Programme, the Group has agreed in principle a recovery plan with the trustees. Under the plan, deficit contributions of £412 million are payable during 2018, rising to £618 million in 2019, £798 million in 2020, £1,287 million in 2021 and £1,305 million per annum from 2022 to 2024. Contributions in the later years will be subject to review and renegotiation at subsequent funding valuations. The next funding valuation is due to be completed by March 2021 with an effective date of 31 December 2019. The deficit contributions are in addition to the regular contributions to meet benefits accruing over the year. The Group currently expects to pay contributions of approximately £750 million to its defined benefit schemes in 2018.

During 2009, the Group made one-off contributions to the Lloyds Bank Pension Scheme No 1 and Lloyds Bank Pension Scheme No 2 in the form of interests in limited liability partnerships for each of the two schemes which hold assets to provide security for the Group's obligations to the two schemes. At 31 December 2017, the limited liability partnerships held assets of approximately £5.5 billion. The limited liability partnerships are consolidated fully in the Group's balance sheet.

The Group has also established three private limited companies which hold assets to provide security for the Group's obligations to the HBOS Final Salary Pension Scheme, a section of the Lloyds Bank Pension Scheme No 1 and the Lloyds Bank Offshore Pension Scheme. At 31 December 2017 these held assets of approximately £4.8 billion in aggregate. The private limited companies are consolidated fully in the Group's balance sheet. The terms of these arrangements require the Group to maintain assets in these vehicles to agreed minimum values in order to secure obligations owed to the relevant Group pension schemes. The Group has satisfied this requirement during 2017.

The last funding valuations of other Group schemes were carried out on a number of different dates. In order to report the position under IAS 19 as at 31 December 2017 the most recent valuation results for all schemes have been updated by qualified independent actuaries. The main differences between the funding and IAS 19 valuations are the different and more prudent approach to setting the discount rate and more conservative longevity assumptions used in the funding valuations.

30 Retirement benefit obligations (continued)

(ii) Amounts in the financial statements

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Amount included in the balance sheet				
Present value of funded obligations	**(43,136)**	(44,363)	**(27,041)**	(27,924)
Fair value of scheme assets	**43,722**	44,249	**27,674**	27,901
Net amount recognised in the balance sheet	**586**	(114)	**633**	(23)

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Net amount recognised in the balance sheet				
At 1 January	**(114)**	736	**(23)**	363
Net defined benefit pension charge	**(334)**	(279)	**(162)**	(133)
Actuarial gains (losses) on defined benefit obligation	**(754)**	(8,770)	**(430)**	(8,293)
Return on plan assets	**1,223**	7,455	**857**	7,624
Employer contributions	**567**	623	**396**	420
Exchange and other adjustments	**(2)**	(9)	**(5)**	(4)
Transfer to disposal group (see note 12)	**–**	130	**–**	–
At 31 December	**586**	(114)	**633**	(23)

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Movements in the defined benefit obligation				
At 1 January	**(44,363)**	(36,903)	**(27,924)**	(19,542)
Current service cost	**(279)**	(257)	**(137)**	(121)
Interest expense	**(1,203)**	(1,401)	**(762)**	(864)
Remeasurements:				
Actuarial gains – experience	**(358)**	535	**(360)**	306
Actuarial (losses) gains – demographic assumptions	**1,031**	195	**874**	115
Actuarial (losses) gains – financial assumptions	**(1,427)**	(9,500)	**(944)**	(8,714)
Benefits paid	**3,537**	1,580	**2,340**	921
Past service cost	**(14)**	(20)	**(4)**	(3)
Employee contributions	**–**	–	**–**	–
Settlements	**16**	12	**–**	–
Curtailments	**(4)**	–	**–**	–
Exchange and other adjustments	**(72)**	(63)	**(124)**	(22)
Transfer to disposal group	**–**	1,459	**–**	–
At 31 December	**(43,136)**	(44,363)	**(27,041)**	(27,924)

30 Retirement benefit obligations (continued)

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Analysis of the defined benefit obligation:				
Active members	**(7,667)**	(9,533)	**(4,349)**	(5,233)
Deferred members	**(15,313)**	(16,368)	**(9,594)**	(10,385)
Pensioners	**(18,556)**	(16,956)	**(11,932)**	(11,170)
Dependants	**(1,600)**	(1,506)	**(1,166)**	(1,136)
	(43,136)	(44,363)	**(27,041)**	(27,924)

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Changes in the fair value of scheme assets				
At 1 January	**44,249**	37,639	**27,901**	19,905
Return on plan assets excluding amounts included in interest income	**1,223**	7,455	**857**	7,624
Interest income	**1,208**	1,441	**766**	879
Employer contributions	**567**	623	**396**	420
Employee contributions	**–**	–	**–**	–
Benefits paid	**(3,537)**	(1,580)	**(2,340)**	(921)
Settlements	**(18)**	(18)	**–**	–
Administrative costs paid	**(40)**	(36)	**(25)**	(24)
Exchange and other adjustments	**70**	54	**119**	18
Transfer to disposal group	**–**	(1,329)	**–**	–
At 31 December	**43,722**	44,249	**27,674**	27,901

30 Retirement benefit obligations (continued)

Composition of scheme assets:

The Group	2017 Quoted £m	2017 Unquoted £m	2017 Total £m	2016 Quoted £m	2016 Unquoted £m	2016 Total £m
Equity instruments	**846**	**5**	**851**	1,114	–	1,114
Debt instruments[1]:						
Fixed interest government bonds	**5,190**	**–**	**5,190**	5,663	–	5,663
Index-linked government bonds	**17,131**	**–**	**17,131**	13,999	–	13,999
Corporate and other debt securities	**6,903**	**–**	**6,903**	7,452	–	7,452
Asset-backed securities	**121**	**–**	**121**	100	–	100
	29,345	**–**	**29,345**	27,214	–	27,214
Property	**–**	**544**	**544**	–	497	497
Pooled investment vehicles	**3,805**	**12,903**	**16,708**	3,569	12,115	15,684
Money market instruments, derivatives, cash and other assets and liabilities	**1,462**	**(5,188)**	**(3,726)**	1,435	(1,695)	(260)
At 31 December	**35,458**	**8,264**	**43,722**	33,332	10,917	44,249

[1] Of the total debt instruments, £27,270 million (31 December 2016: £25,219 million) were investment grade (credit ratings equal to or better than 'BBB').

The Bank	2017 Quoted £m	2017 Unquoted £m	2017 Total £m	2016 Quoted £m	2016 Unquoted £m	2016 Total £m
Equity instruments	**448**	**4**	**452**	405	–	405
Debt instruments[1]:						
Fixed interest government bonds	**417**	**–**	**417**	768	–	768
Index-linked government bonds	**11,215**	**–**	**11,215**	10,546	–	10,546
Corporate and other debt securities	**4,859**	**–**	**4,859**	4,419	–	4,419
Asset-backed securities	**–**	**–**	**–**	–	–	–
	16,491	**–**	**16,491**	15,733	–	15,733
Property	**–**	**–**	**–**	–	13	13
Pooled investment vehicles	**1,495**	**9,541**	**11,036**	2,873	8,992	11,865
Money market instruments, derivatives, cash and other assets and liabilities	**515**	**(820)**	**(305)**	298	(413)	(115)
At 31 December	**18,949**	**8,725**	**27,674**	19,309	8,592	27,901

[1] Of the total debt instruments, £16,212 million (31 December 2016: £14,222 million) were investment grade (credit ratings equal to or better than 'BBB').

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

The pension schemes' pooled investment vehicles comprise:

	The Group 2017 £m	The Group 2016 £m	The Bank 2017 £m	The Bank 2016 £m
Equity funds	**2,421**	2,628	**1,939**	2,244
Hedge and mutual funds	**2,377**	2,347	**1,319**	1,118
Liquidity funds	**2,796**	484	**1,369**	2
Bond and debt funds	**1,729**	3,032	**1,080**	2,837
Other	**7,385**	7,193	**5,329**	5,664
At 31 December	**16,708**	15,684	**11,036**	11,865

30 Retirement benefit obligations (continued)

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

	The Group	
	2017 £m	2016 £m
Current service cost	**279**	257
Net interest amount	**(5)**	(40)
Past service credits and curtailments	**4**	–
Settlements	**2**	6
Past service cost – plan amendments	**14**	20
Plan administration costs incurred during the year	**40**	36
Total defined benefit pension expense[1]	**334**	279

[1] Of the total defined benefit pension expense in 2016, £16 million was included in discontinued operations (see note 12).

Assumptions

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

	2017 %	2016 %
Discount rate	**2.59**	2.76
Rate of inflation:		
Retail Prices Index	**3.20**	3.23
Consumer Price Index	**2.15**	2.18
Rate of salary increases	**0.00**	0.00
Weighted-average rate of increase for pensions in payment	**2.71**	2.72
	2017 Years	2016 Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.9**	28.1
Women	**29.5**	30.3
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.9**	29.3
Women	**30.7**	31.7

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 at 31 December 2017 is assumed to live for, on average, 27.9 years for a male and 29.5 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years' time at age 60.

(iii) Amount timing and uncertainty of future cash flows

Risk exposure of the defined benefit schemes

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

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

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

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

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

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

30 Retirement benefit obligations (continued)

Sensitivity analysis

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

	Effect of reasonably possible alternative assumptions			
	Increase (decrease) in the income statement charge		**Increase (decrease) in the net defined benefit pension scheme liability**	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Inflation (including pension increases):[1]				
Increase of 0.1 per cent	**16**	19	**472**	491
Decrease of 0.1 per cent	**(15)**	(14)	**(453)**	(458)
Discount rate:[2]				
Increase of 0.1 per cent	**(28)**	(30)	**(773)**	(821)
Decrease of 0.1 per cent	**26**	30	**794**	847
Expected life expectancy of members:				
Increase of one year	**44**	42	**1,404**	1,213
Decrease of one year	**(41)**	(37)	**(1,357)**	(1,178)

[1] At 31 December 2017, the assumed rate of RPI inflation is 3.20 per cent and CPI inflation 2.15 per cent (2016: RPI 3.23 per cent and CPI 2.18 per cent).

[2] At 31 December 2017, the assumed discount rate is 2.59 per cent (2016: 2.76 per cent).

Sensitivity analysis method and assumptions

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

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

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

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

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

Asset-liability matching strategies

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

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

At 31 December 2017 the asset-liability matching strategy mitigated 98 per cent of the liability sensitivity to interest rate movements and 102 per cent of the liability sensitivity to inflation movements. Much of the residual interest rate sensitivity is mitigated through holdings of corporate and other debt securities.

30 Retirement benefit obligations (continued)

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

	The Group		The Bank	
	2017 Years	2016 Years	**2017 Years**	2016 Years
Duration of the defined benefit obligation	**19**	20	**18**	19

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Maturity analysis of benefits expected to be paid				
Benefits expected to be paid within 12 months	**1,150**	1,549	**797**	951
Benefits expected to be paid between 1 and 2 years	**1,216**	1,156	**851**	811
Benefits expected to be paid between 2 and 5 years	**4,023**	3,889	**2,801**	2,706
Benefits expected to be paid between 5 and 10 years	**7,939**	7,852	**5,397**	5,338
Benefits expected to be paid between 10 and 15 years	**9,166**	9,212	**6,019**	6,051
Benefits expected to be paid between 15 and 25 years	**18,526**	19,615	**11,448**	12,217
Benefits expected to be paid between 25 and 35 years	**16,157**	18,090	**9,485**	10,766
Benefits expected to be paid between 35 and 45 years	**10,640**	12,915	**5,774**	7,270
Benefits expected to be paid in more than 45 years	**4,724**	7,122	**2,093**	3,541

Defined contribution schemes
The Group operates a number of defined contribution pension schemes in the UK and overseas, principally Your Tomorrow and the defined contribution sections of the Lloyds Bank Pension Scheme No. 1.

During the year ended 31 December 2017 the charge to the continuing operations income statement in respect of defined contribution schemes was £242 million (2016: £254 million), representing the contributions payable by the employer in accordance with each scheme's rules. In addition, £14 million (2016: £14 million) was charged within discontinued operations (see note 12).

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2017 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.81 per cent (2016: 6.84 per cent).

Movements in the other post-retirement benefits obligation:

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
At 1 January	**(236)**	(200)	**(122)**	(109)
Actuarial gains (losses)	**92**	(33)	**15**	(13)
Insurance premiums paid	**7**	7	**5**	5
Charge for the year	**(7)**	(8)	**(3)**	(3)
Exchange and other adjustments	**–**	(2)	**2**	(2)
At 31 December	**(144)**	(236)	**(103)**	(122)

31 Deferred tax

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Statutory position				
Deferred tax assets	**3,104**	3,603	**1,995**	2,286
Deferred tax liabilities	**–**	–	**–**	–
Net deferred tax asset	**3,104**	3,603	**1,995**	2,286
Tax disclosure				
Deferred tax assets	**4,904**	5,479	**2,954**	3,365
Deferred tax liabilities	**(1,800)**	(1,876)	**(959)**	(1,079)
Net deferred tax asset	**3,104**	3,603	**1,995**	2,286

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

The UK corporation tax rate will reduce from 19 per cent to 17 per cent on 1 April 2020. The Group measures its deferred tax assets and liabilities at the value expected to be recoverable or payable in future periods, and re-measures them at each reporting date based on the most recent estimates of utilisation or settlement, including the impact of bank surcharge where appropriate. The deferred tax impact of this re-measurement in 2017 is a charge of £21 million in the income statement and a credit of £25 million in other comprehensive income.

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	Property, plant and equipment £m	Pension liabilities £m	Provisions £m	Share-based payments £m	Other temporary differences £m	Total £m
At 1 January 2016	4,834	1,065	94	38	45	203	6,279
(Charge) credit to the income statement	(580)	(128)	(2,011)	12	(17)	(179)	(2,903)
(Charge) credit to other comprehensive income	–	–	2,113	(10)	–	–	2,103
At 31 December 2016	4,254	937	196	40	28	24	5,479
(Charge) credit to the income statement	**(243)**	**(222)**	**(281)**	**(9)**	**7**	**(19)**	**(767)**
(Charge) credit to other comprehensive income	**–**	**–**	**164**	**25**	**–**	**–**	**189**
Impact of acquisitions and disposals	**–**	**–**	**–**	**–**	**–**	**3**	**3**
At 31 December 2017	**4,011**	**715**	**79**	**56**	**35**	**8**	**4,904**

Deferred tax liabilities	Acquisition fair value £m	Pension assets £m	Derivatives £m	Available-for-sale asset revaluation £m	Other temporary differences £m	Total £m
At 1 January 2016	(831)	(174)	(431)	(11)	(209)	(1,656)
(Charge) credit to the income statement	86	1,876	241	24	52	2,279
(Charge) credit to other comprehensive income	–	(1,787)	(466)	(246)	–	(2,499)
At 31 December 2016	(745)	(85)	(656)	(233)	(157)	(1,876)
(Charge) credit to the income statement	**70**	**199**	**(120)**	**(36)**	**65**	**178**
(Charge) credit to other comprehensive income	**–**	**(295)**	**284**	**68**	**–**	**57**
Impact of acquisitions and disposals	**(157)**	**–**	**–**	**–**	**(2)**	**(159)**
At 31 December 2017	**(832)**	**(181)**	**(492)**	**(201)**	**(94)**	**(1,800)**

31 Deferred tax (continued)

The Bank **Deferred tax assets**	Tax losses £m	Property, plant and equipment £m	Pension liabilities £m	Provisions £m	Share-based payments £m	Other temporary differences £m	Total £m
At 1 January 2016	3,192	688	65	38	45	–	4,028
(Charge) credit to the income statement	(586)	(111)	(2,189)	(2)	(17)	–	(2,905)
(Charge) credit to other comprehensive income	–	–	2,242	–	–	–	2,242
At 31 December 2016	2,606	577	118	36	28	–	3,365
(Charge) credit to the income statement	**(173)**	**(173)**	**(211)**	**(14)**	**(3)**	**5**	**(569)**
(Charge) credit to other comprehensive income	**–**	**–**	**133**	**25**	**–**	**–**	**158**
At 31 December 2017	**2,433**	**404**	**40**	**47**	**25**	**5**	**2,954**

Deferred tax liabilities	Pension assets £m	Derivatives £m	Available-for-sale asset revaluation £m	Other temporary differences £m	Total £m
At 1 January 2016	(109)	(390)	–	(39)	(538)
(Charge) credit to the income statement	2,098	–	(6)	(96)	1,996
(Charge) credit to other comprehensive income	(2,058)	(258)	(219)	–	(2,535)
Exchange and other adjustments	–	–	–	(2)	(2)
At 31 December 2016	(69)	(648)	(225)	(137)	(1,079)
(Charge) credit to the income statement	**137**	**–**	**(24)**	**74**	**187**
(Charge) credit to other comprehensive income	**(243)**	**130**	**46**	**–**	**(67)**
At 31 December 2017	**(175)**	**(518)**	**(203)**	**(63)**	**(959)**

Critical accounting estimates and judgments

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised.

The Group has recognised a deferred tax asset of £4,011 million (2016: £4,254 million) and the Bank £2,433 million (2016: £2,606 million) in respect of UK trading losses carried forward. Substantially all of these losses have arisen in Bank of Scotland plc and Lloyds Bank plc, and they will be utilised as taxable profits arise in those legal entities in future periods.

The Group's expectations as to the level of future taxable profits take into account the Group's long-term financial and strategic plans, and anticipated future tax-adjusting items. In making this assessment, account is taken of business plans as well as the risks associated with future regulatory change.

Under current law there is no expiry date for UK trading losses not yet utilised, although (since Finance Act 2016) banking losses that arose before 1 April 2015 can only be used against 25 per cent of taxable profits arising after 1 April 2016, and they cannot be used to reduce the surcharge on banking profits. This restriction in utilisation means that the value of the deferred tax asset is only expected to be fully recovered by 2034.

Deferred tax not recognised

No deferred tax has been recognised in respect of foreign trade losses where it is not more likely than not that we will be able to utilise them in future periods. Of the asset not recognised, £35 million for the Group and £nil for the Bank (2016: £63 million for the Group and £nil for the Bank) relates to losses that will expire if not used within 20 years, and £56 million for the Group and £11 million for the Bank (2016: £56 million for the Group and £12 million for the Bank) relates to losses with no expiry date.

Deferred tax assets of approximately £76 million (2016: £92 million) for the Group and £23 million (2016: £31 million) for the Bank have not been recognised in respect of £404 million of UK tax losses and other temporary differences which can only be used to offset future capital gains. UK capital losses can be carried forward indefinitely.

In addition, no deferred tax asset is recognised in respect of unrelieved foreign tax credits of £46 million (2016: £46 million) for the Group and £7 million (2016: £7 million) for the Bank, as there are no expected future taxable profits against which the credits can be utilised. These credits can be carried forward indefinitely.

As a result of parent company exemptions on dividends from subsidiaries and on capital gains on disposal there are no significant taxable temporary differences associated with investments in subsidiaries, branches, associates and joint arrangements.

32 Other provisions

Critical accounting estimates and judgments
At 31 December 2017, the Group carried provisions of £3,859 million (2016: £3,723 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches, principally the mis-selling of payment protection insurance (2017: £2,775 million; 2016: £2,602 million).

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

More detail on the nature of the assumptions that have been made and key sensitivities is set out below.

The Group	Provisions for commitments £m	Payment protection insurance £m	Other regulatory provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2017	**56**	**2,602**	**1,121**	**51**	**1,103**	**4,933**
Exchange and other adjustments	(26)	–	(15)	9	165	133
Acquisition of business (note 20)	9	527	–	–	92	628
Provisions applied	–	(1,654)	(844)	(23)	(230)	(2,751)
Charge (release) for the year	(9)	1,300	822	19	234	2,366
At 31 December 2017	**30**	**2,775**	**1,084**	**56**	**1,364**	**5,309**

The Bank	Provisions for commitments £m	Payment protection insurance £m	Other regulatory provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2017	**21**	**1,513**	**299**	**29**	**971**	**2,833**
Exchange and other adjustments	–	–	31	–	32	63
Provisions applied	–	(946)	(430)	(15)	(252)	(1,643)
Charge (release) for the year	(3)	781	342	20	200	1,340
At 31 December 2017	**18**	**1,348**	**242**	**34**	**951**	**2,593**

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

Payment protection insurance (excluding MBNA)
The Group increased the provision for PPI costs by a further £1,300 million in 2017, of which £600 million was in the fourth quarter, bringing the total amount provided to £18,646 million. The remaining provision is consistent with an average of 11,000 complaints per week (previously 9,000) through to the industry deadline of August 2019, in line with the average experience over the last nine months.

The higher volume of complaints received has been driven by increased claims management company (CMC) marketing activity and the Financial Conduct Authority (FCA) advertising campaign.

At 31 December 2017, a provision of £2,435 million remained unutilised relating to complaints and associated administration costs. Total cash payments were £1,467 million during the year to 31 December 2017.

Sensitivities
The Group estimates that it has sold approximately 16 million PPI policies since 2000. These include policies that were not mis-sold and those that have been successfully claimed upon. Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for approximately 53 per cent of the policies sold since 2000.

The total amount provided for PPI represents the Group's best estimate of the likely future cost. However a number of risks and uncertainties remain in particular with respect to future volumes. The cost could differ from the Group's estimates and the assumptions underpinning them, and could result in a further provision being required. There is significant uncertainty around the impact of the regulatory changes, FCA media campaign and Claims Management Company and customer activity.

For every additional 1,000 reactive complaints per week above 11,000 on average through to the industry deadline of August 2019, the Group would expect an additional charge of £200 million.

Payment protection insurance (MBNA)
With regard to MBNA, as announced in December 2016, the Group's exposure is capped at £240 million already provided for, through an indemnity received from Bank of America.

32 Other provisions (continued)

Other provisions for legal actions and regulatory matters
In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints in connection with its past conduct and claims brought by or on behalf of current and former employees, customers, investors and other third parties and is subject to legal proceedings and other legal actions. Where significant, provisions are held against the costs expected to be incurred in relation to these matters and matters arising from related internal reviews. During the year ended 31 December 2017 the Group charged a further £822 million in respect of legal actions and other regulatory matters, the unutilised balance at 31 December 2017 was £1,084 million (31 December 2016: £1,121 million). The most significant items are as follows.

Arrears handling related activities
The Group has provided an additional £245 million (bringing the total provided to date to £642 million), for the costs of identifying and rectifying certain arrears management fees and activities. Following a review of the Group's arrears handling activities, the Group has put in place a number of actions to improve further its handling of customers in these areas and has made good progress in reimbursing mortgage arrears fees to the 590,000 impacted customers.

Packaged bank accounts
In 2017 the Group provided an additional £245 million in respect of complaints relating to alleged mis-selling of packaged bank accounts raising the total amount provided to £750 million. A number of risks and uncertainties remain in particular with respect to future volumes.

HBOS Reading – customer review
The Group is undertaking a review into a number of customer cases from the former HBOS Impaired Assets Office based in Reading. This review follows the conclusion of a criminal trial in which a number of individuals, including two former HBOS employees, were convicted of conspiracy to corrupt, fraudulent trading and associated money laundering offences which occurred prior to the acquisition of HBOS by the Lloyds Banking Group in 2009. The Group has provided £100 million in the year to 31 December 2017 and is in the process of paying compensation to the victims of the fraud for economic losses as well as ex-gratia payments and awards for distress and inconvenience. The review is ongoing and at 12 February 2018, the Group had made offers to 57 customers, which represents more than 80 per cent of the customers in review.

Vacant leasehold property
Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a biannual basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging 5 years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Other
Following the sale of TSB Banking Group plc in 2015, the Group raised a provision of £665 million in relation to the Transitional Service Agreement entered into between Lloyds Bank plc and TSB and the contribution to be provided to TSB in moving to alternative IT provision; £622 million of this provision remained unutilised at 31 December 2017.

Provisions are made for staff and other costs related to Group restructuring initiatives at the point at which the Group becomes irrevocably committed to the expenditure. At 31 December 2017 provisions of £104 million (31 December 2016: £239 million) were held.

Other provisions also includes those arising in the normal course of business, whether from certain customer rectifications or provisions for dilapidation and refurbishment of properties. Provisions also include a matter arising out of the insolvency of a third party insurer, which remains exposed to asbestos and pollution claims in the US. The ultimate cost and timing of payments are uncertain. The provision held of £32 million at 31 December 2017 represents management's current best estimate of the cost after having regard to actuarial estimates of future losses.

33 Subordinated liabilities

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

The Group	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2016	6,257	1,601	20,332	28,190
Issued during the year:				
4.293% Subordinated Fixed Rate Note 2021 ($824 million)	–	–	605	605
4.503% Subordinated Fixed Rate Note 2021 ($1,353 million)	–	–	993	993
4.553% Subordinated Fixed Rate Note 2021 ($1,500 million)	–	–	1,155	1,155
	–	–	2,753	2,753
Repurchases and redemptions during the year:				
7.875% Non–cumulative Preference Shares callable 2013	(367)	–	–	(367)
7.875% Non–cumulative Preference Shares callable 2013	(844)	–	–	(844)
6.267% Non–cumulative Callable Fixed to Floating Rate Preference Shares callable 2016	(675)	–	–	(675)
7.286% Perpetual Regulatory Tier One Securities (Series A)	(150)	–	–	(150)
4.939% Non–voting Non–cumulative Perpetual Preferred Securities	(32)	–	–	(32)
Primary Capital Undated Floating Rate Notes:				
Series 1	–	(101)	–	(101)
Series 3	–	(142)	–	(142)
Series 2	–	(110)	–	(110)
5.125% Undated Subordinated Step–up Notes callable 2016	–	(2)	–	(2)
6% Undated Subordinated Step–up Guaranteed Bonds callable 2032	–	(114)	–	(114)
7.5% Undated Subordinated Step–up Notes	–	(5)	–	(5)
4.25% Subordinated Undated Instruments	–	(7)	–	(7)
Floating Rate Primary Capital Notes	–	(108)	–	(108)
13% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(244)	(244)
10.125% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(233)	(233)
11.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(960)	(960)
10.75% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(466)	(466)
9.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(456)	(456)
10.25% Subordinated Notes 2020	–	–	(388)	(388)
10.26% Subordinated Notes 2020	–	–	(417)	(417)
Subordinated Non–Interest Bearing loan on rolling 6 year notice	–	–	(150)	(150)
10.23% Subordinated Notes 2019	–	–	(894)	(894)
10.31% Subordinated Notes 2020	–	–	(748)	(748)
10.38% Subordinated Notes 2020	–	–	(653)	(653)
10.42% Subordinated Notes 2020	–	–	(532)	(532)
10.45% Subordinated Notes 2022	–	–	(93)	(93)
10.54% Subordinated Notes 2019	–	–	(91)	(91)
10.56% Subordinated Notes 2019	–	–	(297)	(297)
10.59% Subordinated Notes 2019	–	–	(4)	(4)
10.58% Subordinated Notes 2020	–	–	(196)	(196)
10.60% Subordinated Notes 2019	–	–	(136)	(136)
10.62% Subordinated Notes 2023	–	–	(97)	(97)
10.59% Subordinated Notes 2020	–	–	(61)	(61)
10.62% Subordinated Notes 2024	–	–	(79)	(79)
10.64% Subordinated Notes 2020	–	–	(138)	(138)
10.65% Subordinated Notes 2024	–	–	(37)	(37)
10.66% Subordinated Notes 2020	–	–	(39)	(39)
10.73% Subordinated Notes 2024	–	–	(85)	(85)

33 Subordinated liabilities (continued)

The Group	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
10.88% Subordinated Notes 2023	–	–	(53)	(53)
10.91% Subordinated Notes 2023	–	–	(66)	(66)
11.14% Subordinated Notes 2029	–	–	(89)	(89)
11.19% Subordinated Notes 2032	–	–	(81)	(81)
10.25% Subordinated Notes 2020	–	–	(251)	(251)
10.27% Subordinated Notes 2020	–	–	(779)	(779)
10.30% Subordinated Notes 2020	–	–	(601)	(601)
9.95% Subordinated Notes 2020	–	–	(28)	(28)
10.22% Subordinated Notes 2020	–	–	(56)	(56)
10.29% Subordinated Notes 2020	–	–	(140)	(140)
10.36% Subordinated Notes 2021	–	–	(171)	(171)
9.84% Subordinated Notes 2019	–	–	(400)	(400)
10.19% Subordinated Notes 2020	–	–	(82)	(82)
10.76% Subordinated Notes 2029	–	–	(86)	(86)
Callable Floating Rate Subordinated Notes 2016	–	–	(186)	(186)
Callable Floating Rate Subordinated Notes 2016	–	–	(144)	(144)
Subordinated Callable Notes 2016	–	–	(382)	(382)
	(2,068)	(589)	(11,089)	(13,746)
Foreign exchange and other movements	577	199	1,653	2,429
Transfer to disposal group (see note 12)	(18)	(586)	(1,764)	(2,368)
At 31 December 2016	4,748	625	11,885	17,258
Repurchases and redemptions during the year[1]:				
6.369% Fixed/Floating Rate Non-Cumulative Securities Callable 2015	**(600)**	**–**	**–**	**(600)**
4.385% Step-up Perpetual Capital Securities Callable 2017	**(74)**	**–**	**–**	**(74)**
7.627% Fixed to Floating Rate Guaranteed Non-Voting Non-Cumulative Preferred Securities	**(163)**	**–**	**–**	**(163)**
Undated Loan Capital	**–**	**(90)**	**–**	**(90)**
Subordinated Callable Notes 2017	**–**	**–**	**(771)**	**(771)**
	(837)	**(90)**	**(771)**	**(1,698)**
Foreign exchange movements	**(221)**	**(34)**	**(423)**	**(678)**
Other movements (all non-cash)	**31**	**3**	**(134)**	**(100)**
At 31 December 2017	**3,721**	**504**	**10,557**	**14,782**

[1] The repurchases and redemptions in the year resulted in cash outflows of £1,608 million (2016: £15,207 million).

33 Subordinated liabilities (continued)

The Bank	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2016	4,716	832	14,161	19,709
Issued in the year:				
4.293% Subordinated Fixed Rate Note 2021 ($824 million)	–	–	605	605
4.503% Subordinated Fixed Rate Note 2021 ($1,353 million)	–	–	993	993
4.553% Subordinated Fixed Rate Note 2021 ($1,500 million)	–	–	1,155	1,155
	–	–	2,753	2,753
Repurchases and redemptions during the year:				
7.875% Non-cumulative Preference Shares callable 2013	(367)	–	–	(367)
7.875% Non-cumulative Preference Shares callable 2013	(844)	–	–	(844)
6.267% Non-cumulative Callable Fixed to Floating Rate Preference Shares callable 2016	(675)	–	–	(675)
Primary Capital Undated Floating Rate Notes:				
Series 1	–	(101)	–	(101)
Series 3	–	(142)	–	(142)
Series 2	–	(110)	–	(110)
5.125% Undated Subordinated Step-up Notes callable 2016	–	(2)	–	(2)
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032	–	(114)	–	(114)
13% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(244)	(244)
10.125% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(233)	(233)
11.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(960)	(960)
10.75% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(466)	(466)
9.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016	–	–	(456)	(456)
10.25%Subordinated Notes 2020	–	–	(388)	(388)
10.26%Subordinated Notes 2020	–	–	(417)	(417)
Subordinated Non-Interest Bearing loan on rolling 6 year notice	–	–	(150)	(150)
10.23% Subordinated Notes 2019	–	–	(894)	(894)
10.31% Subordinated Notes 2020	–	–	(748)	(748)
10.38% Subordinated Notes 2020	–	–	(653)	(653)
10.42% Subordinated Notes 2020	–	–	(532)	(532)
10.45% Subordinated Notes 2022	–	–	(93)	(93)
10.54% Subordinated Notes 2019	–	–	(91)	(91)
10.56% Subordinated Notes 2019	–	–	(297)	(297)
10.59% Subordinated Notes 2019	–	–	(4)	(4)
10.58% Subordinated Notes 2020	–	–	(196)	(196)
10.60% Subordinated Notes 2019	–	–	(136)	(136)
10.62% Subordinated Notes 2023	–	–	(97)	(97)
10.59% Subordinated Notes 2020	–	–	(61)	(61)
10.62% Subordinated Notes 2024	–	–	(79)	(79)
10.64% Subordinated Notes 2020	–	–	(138)	(138)
10.65% Subordinated Notes 2024	–	–	(37)	(37)
10.66% Subordinated Notes 2020	–	–	(39)	(39)
10.73% Subordinated Notes 2024	–	–	(85)	(85)
10.88% Subordinated Notes 2023	–	–	(53)	(53)
10.91% Subordinated Notes 2023	–	–	(66)	(66)
11.14% Subordinated Notes 2029	–	–	(89)	(89)
11.19% Subordinated Notes 2032	–	–	(81)	(81)
10.25% Subordinated Notes 2020	–	–	(251)	(251)
10.27% Subordinated Notes 2020	–	–	(779)	(779)
10.30% Subordinated Notes 2020	–	–	(601)	(601)

33 Subordinated liabilities (continued)

The Bank	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
9.95% Subordinated Notes 2020	–	–	(28)	(28)
10.22% Subordinated Notes 2020	–	–	(56)	(56)
10.29% Subordinated Notes 2020	–	–	(140)	(140)
10.36% Subordinated Notes 2021	–	–	(171)	(171)
9.84% Subordinated Notes 2019	–	–	(400)	(400)
10.19% Subordinated Notes 2020	–	–	(82)	(82)
10.76% Subordinated Notes 2029	–	–	(86)	(86)
	(1,886)	(469)	(10,377)	(12,732)
Foreign exchange and other movements	264	87	494	845
At 31 December 2016	3,094	450	7,031	10,575
Repurchases and redemptions during the year[1]:				
6.369% Fixed/Floating Rate Non-Cumulative Securities Callable 2015	**(600)**	**–**	**–**	**(600)**
4.385% Step-up Perpetual Capital Securities Callable 2017	**(74)**	**–**	**–**	**(74)**
	(674)	**–**	**–**	**(674)**
Foreign exchange movements	**(153)**	**(31)**	**(260)**	**(444)**
Other movements (all non-cash)	**(16)**	**(1)**	**(99)**	**(116)**
At 31 December 2017	**2,251**	**418**	**6,672**	**9,341**

[1] The repurchases and redemptions in the year resulted in cash outflows of £675 million (2016: £13,200 million).

These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of the specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preference shares and preferred securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of the holders of the dated subordinated liabilities. Neither the Group nor the Bank has had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year (2016: none).

34 Share capital

(1) Authorised share capital

	Group and Bank 2017 £m	Group and Bank 2016 £m
Sterling		
1,650 million ordinary shares of £1 each	**1,650**	1,650
1 cumulative floating rate Preference share of £1	**–**	–
100 6 per cent Non-Cumulative Redeemable Preference shares of £1 each	**–**	–
175 million Preference shares of 25p each	**44**	44
	1,694	1,694

US dollars	**US$m**	US$m
160 million Preference shares of 25 cents each	**40**	40

Euro	**€m**	€m
160 million Preference shares of 25 cents each	**40**	40

Japanese yen	**¥m**	¥m
50 million Preference shares of ¥25 each	**1,250**	1,250

(2) Issued and fully paid ordinary shares

	2017 Number of shares	2016 Number of shares	**2017 £m**	2016 £m
Sterling				
Ordinary shares of £1 each				
At 1 January and 31 December	**1,574,285,751**	1,574,285,751	**1,574**	1,574

Share capital and control
There are no 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 2017, 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.

Issued and fully paid preference shares
The Bank has in issue various classes of preference shares which are all classified as liabilities under IFRS and details of which are shown in note 33.

35 Share premium account

	Group and Bank 2017 £m	Group and Bank 2016 £m
At 1 January	**–**	35,533
Redemption of preference shares[1]	**600**	1,840
Capital restructuring[2]	**–**	(37,373)
At 31 December	**600**	–

[1] During the year ended 31 December 2017, the Bank redeemed all of its outstanding 6.369% Fixed/Floating Rate Non-Cumulative Preference Shares Callable 2015 which had been accounted for as subordinated liabilities. On redemption an amount of £600 million was transferred from retained profits to the share premium account.
During the year ended 31 December 2016, the Bank redeemed all of its outstanding Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million), 7.875% Non-cumulative Preference Shares callable 2013 (€500 million) and 7.875% Non-cumulative Preference Shares callable 2013 (US$1,250 million) which had been accounted for as subordinated liabilities. On redemption an amount of £1,840 million was transferred from retained profits to the share premium account.

[2] During the year ended 31 December 2016 the Bank reduced its share premium account by Special Resolution which was confirmed by an order of the High Court of Justice, Chancery Division on 23 November 2016. The balance on the share premium account of £37,373 million has been transferred to retained profits.

36 Other reserves

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Other reserves comprise:				
Merger reserve	**6,348**	6,348	**–**	–
Revaluation reserve in respect of available-for-sale financial assets	**(8)**	92	**611**	667
Cash flow hedging reserve	**1,573**	2,224	**1,554**	1,845
Foreign currency translation reserve	**(207)**	(180)	**76**	81
At 31 December	**7,706**	8,484	**2,241**	2,593

Movements in other reserves were as follows:

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Merger reserve				
At 1 January and 31 December	**6,348**	6,348	**–**	–

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Revaluation reserve in respect of available-for-sale financial assets				
At 1 January	**92**	(1,105)	**667**	(541)
Adjustment on transfer from held-to-maturity portfolio	**–**	1,544	**–**	1,544
Deferred tax	**–**	(417)	**–**	(417)
	–	1,127	**–**	1,127
Change in fair value of available-for-sale financial assets	**294**	356	**231**	268
Deferred tax	**(25)**	(25)	**(39)**	(20)
Current tax	**(4)**	(3)	**–**	–
	265	328	**192**	248
Income statement transfers:				
Disposals (see note 8)	**(464)**	(575)	**(333)**	(507)
Deferred tax	**93**	196	**85**	218
Current tax	**–**	(52)	**–**	(50)
	(371)	(431)	**(248)**	(339)
Impairment	**6**	173	**–**	172
Deferred tax	**–**	–	**–**	–
	6	173	**–**	172
At 31 December	**(8)**	92	**611**	667

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Cash flow hedging reserve				
At 1 January	**2,224**	915	**1,845**	1,054
Change in fair value of hedging derivatives	**(271)**	2,284	**15**	1,290
Deferred tax	**103**	(583)	**21**	(321)
	(168)	1,701	**36**	969
Income statement transfers	**(644)**	(531)	**(436)**	(241)
Deferred tax	**161**	139	**109**	63
	(483)	(392)	**(327)**	(178)
At 31 December	**1,573**	2,224	**1,554**	1,845

36 Other reserves (continued)

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Foreign currency translation reserve				
At 1 January	**(180)**	(171)	**81**	62
Currency translation differences arising in the year	**(16)**	(115)	**2**	(62)
Foreign currency (losses) gains on net investment hedges (tax: £nil)	**(11)**	106	**(7)**	81
At 31 December	**(207)**	(180)	**76**	81

37 Retained profits

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
At 1 January	**36,231**	3,868	**50,390**	16,646
Profit for the year[1]	**4,139**	1,102	**5,279**	1,953
Dividends paid (note 39)	**(2,650)**	(3,040)	**(2,650)**	(3,040)
Distributions on other equity instruments, net of tax	**(199)**	(86)	**(199)**	(86)
Redemption of preference shares (note 35)	**(600)**	(1,840)	**(600)**	(1,840)
Capital restructuring	**–**	37,373	**–**	37,373
Post-retirement defined benefit scheme remeasurements	**482**	(1,028)	**332**	(498)
Gains and losses attributable to own credit risk (net of tax)[2]	**(40)**	–	**(40)**	–
Adjustment on vesting of businesses (note 24)	**–**	–	**278**	–
Capital contribution received	**432**	323	**432**	323
Return of capital contribution	**(77)**	(441)	**(77)**	(441)
At 31 December	**37,718**	36,231	**53,145**	50,390

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

[2] During 2017 the Group and the Bank derecognised, on redemption, financial liabilities on which cumulative fair value movements relating to own credit of £3 million (net of tax) had been recognised directly in retained profits.

38 Other equity instruments

	The Group and Bank	
	2017 £m	2016 £m
At 1 January	**3,217**	–
Additional Tier 1 securities issued in the year:		
Sterling notes (£1,376 million nominal)	**–**	1,376
Euro notes (€736 million nominal)	**–**	612
US dollar notes ($1,642 million nominal)	**–**	1,229
	3,217	3,217

The Bank has in issue £3,217 million of Sterling, Dollar and Euro Additional Tier 1 (AT1) securities to Lloyds Banking Group plc. The AT1 securities are fixed rate resetting or 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.

38 Other equity instruments (continued)

- 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 Prudential Regulation Authority.
- 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.

39 Dividends on ordinary shares

	2017 £m	2016 £m
Dividends paid in the year were as follows:		
Final dividend for previous year paid during the current year	**–**	–
Interim dividends	**2,650**	3,040
	2,650	3,040

In February 2018, the Directors approved the payment of a further interim dividend of £7,622 million, subject to the planned sale of Scottish Widows Group Limited to the Bank's parent, Lloyds Banking Group plc, to be effected as part of the Group's ring-fencing planning, happening concurrently. The timing for the payment of this dividend and the sale of Scottish Widows Group Limited is subject to certain conditions.

40 Share-based payments

During the year ended 31 December 2017 Lloyds Banking Group pic operated a number of share-based payment schemes for which employees of the Lloyds Bank Group were eligible and all of which are equity settled. Details of all schemes operated by Lloyds Banking Group are set out below; these are managed and operated on a Lloyds Banking Group-wide basis. The amount charged to the Group's income statement in respect of Lloyds Banking Group share-based payment schemes, and which is included within staff costs (note 9), was £414 million (2016: £420 million) with a further £23 million (2016: £22 million) included within discontinued operations (see note 12).

Deferred bonus plans
The Group operates a number of deferred bonus plans that are equity settled. Bonuses in respect of employee performance in 2017 have been recognised in the charge in line with the proportion of the deferral period completed.

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

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

	2017		2016	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**678,692,896**	**51.76**	850,146,220	50.99
Granted	**268,653,890**	**51.03**	454,667,560	47.49
Exercised	**(13,119,229)**	**55.58**	(401,286,043)	40.74
Forfeited	**(18,545,569)**	**51.70**	(10,590,490)	56.02
Cancelled	**(41,211,075)**	**52.77**	(204,238,535)	60.23
Expired	**(13,603,825)**	**56.98**	(10,005,816)	57.08
Outstanding at 31 December	**860,867,088**	**51.34**	678,692,896	51.76
Exercisable at 31 December	**–**	**–**	–	–

The weighted average share price at the time that the options were exercised during 2017 was £0.67 (2016: £0.67). The weighted average remaining contractual life of options outstanding at the end of the year was 1.4 years (2016: 2.9 years).

The weighted average fair value of SAYE options granted during 2017 was £0.15 (2016: £0.13). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

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

40 Share-based payments (continued)

Options granted on 27 March 2014 under the Commercial Banking Transformation Plan (CBTP), became exercisable in March 2017 and vested at a factor of 2.1 from the original 'on-target' award, due to the degree to which the performance conditions were exceeded. The award was based upon the underlying profit and return on risk-weighted assets ('RoRWA') of Commercial Banking as at 31 December 2016.

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

	2017		2016	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	218,962,281	Nil	221,397,597	Nil
Granted	5,466,405	Nil	4,298,701	Nil
Exercised	(104,967,667)	Nil	(2,700,679)	Nil
Forfeited	(81,883)	Nil	(3,863,477)	Nil
Lapsed	(104,855,147)	Nil	(169,861)	Nil
Outstanding at 31 December	14,523,989	Nil	218,962,281	Nil
Exercisable at 31 December	7,729,919	Nil	4,504,392	Nil

The weighted average fair value of options granted in the year was £0.62 (2016: £0.68). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2017 was £0.69 (2016: £0.64). The weighted average remaining contractual life of options outstanding at the end of the year was 4.9 years (2016: 5.1 years).

Other share plans

Lloyds Banking Group Long-Term Incentive Plan

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

For the 2015 and 2016 LTIPs participants may be entitled to any dividends paid during the vesting period if the performance conditions are met. An amount equal in value to any dividends paid between the award date and the date the Remuneration Committee determine that the performance conditions were met may be paid, based on the number of shares that vest. The Remuneration Committee will determine if any dividends are to be paid in cash or in shares. Details of the performance conditions for the plan are provided in the Directors' remuneration report.

At the end of the performance period for the 2014 grant, the targets had not been fully met and therefore these awards vested in 2017 at a rate of 55 per cent.

	2017 Number of shares	2016 Number of shares
Outstanding at 1 January	358,228,028	398,066,746
Granted	139,812,788	132,194,032
Vested	(57,406,864)	(140,879,465)
Forfeited	(73,268,966)	(33,713,900)
Dividend award	3,439,929	2,560,615
Outstanding at 31 December	370,804,915	358,228,028

Awards in respect of the 2015 grant will vest in 2018 at a rate of 66.3 per cent.

The weighted average fair value of awards granted in the year was £0.57 (2016: £0.64).

The fair value calculations at 31 December 2017 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Save-As-You-Earn	Executive Share Plan 2003	LTIP
Weighted average risk-free interest rate	0.59%	0.18%	0.22%
Weighted average expected life	3.3 years	1.9 years	3.6 years
Weighted average expected volatility	29%	30%	31%
Weighted average expected dividend yield	4.0%	4.0%	0.0%
Weighted average share price	£0.68	£0.67	£0.68
Weighted average exercise price	£0.51	nil	nil

Expected volatility is a measure of the amount by which the Group's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option.

40 Share-based payments (continued)

The historical volatility is compared to the implied volatility generated from market traded options in the Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Share Incentive Plan
Free Shares
An award of shares may be made annually to employees up to a maximum of £3,000. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition. If an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

On 10 May 2017, the Group made an award of £200 of shares to all eligible employees. The number of shares awarded was 21,566,047, with an average fair value of £0.69 based on the market price at the date of award.

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

The number of shares awarded relating to matching shares in 2017 was 32,025,497 (2016: 35,956,224), with an average fair value of £0.67 (2016: £0.61), based on market prices at the date of award.

Fixed share awards
Fixed share awards were introduced in 2014 in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for certain Lloyds Banking Group employees, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The fixed share awards are delivered in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award. The number of shares purchased in 2017 was 9,313,314 (2016: 10,031,272).

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

41 Related party transactions

Key management personnel
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the Group's key management personnel are the members of the Lloyds Banking Group plc Group Executive Committee together with its Non-Executive Directors.

The table below details, on an aggregated basis, key management personnel compensation:

	2017 £m	2016 £m
Compensation		
Salaries and other short-term benefits	**13**	17
Post-employment benefits	**–**	–
Share-based payments	**22**	23
Total compensation	**35**	40

The aggregate of the emoluments of the directors was £14.0 million (2016: £13.6 million).

Aggregate company contributions in respect of key management personnel to defined contribution pension schemes were £0.05 million (2016: £0.1 million).

The total for the highest paid director (António Horta-Osório) was £6,469,000 (2016: (António Horta-Osório) £6,289,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in either year.

	2017 million	2016 million
Share options over Lloyds Banking Group plc shares		
At 1 January	**3**	9
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	**–**	3
Exercised/lapsed (includes entitlements of former key management personnel)	**(2)**	(9)
At 31 December	**1**	3

41 Related party transactions (continued)

	2017 million	2016 million
Share plans settled in Lloyds Banking Group plc shares		
At 1 January	**65**	82
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	**37**	29
Exercised/lapsed (includes entitlements of former key management personnel)	**(20)**	(46)
At 31 December	**82**	65

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

	2017 £m	2016 £m
Loans		
At 1 January	**4**	5
Advanced (includes loans of appointed key management personnel)	**1**	3
Repayments (includes loans of former key management personnel)	**(3)**	(4)
At 31 December	**2**	4

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 6.45 per cent and 23.95 per cent in 2017 (2016: 2.49 per cent and 23.95 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2016: £nil).

	2017 £m	2016 £m
Deposits		
At 1 January	**12**	13
Placed (includes deposits of appointed key management personnel)	**41**	41
Withdrawn (includes deposits of former key management personnel)	**(33)**	(42)
At 31 December	**20**	12

Deposits placed by key management personnel attracted interest rates of up to 4.0 per cent (2016: 4.0 per cent).

At 31 December 2017, the Group did not provide any guarantees in respect of key management personnel (2016: none).

At 31 December 2017, transactions, arrangements and agreements entered into by the Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £0.01 million with 3 directors and 2 connected persons (2016: £0.4 million with five directors and two connected persons).

Balances and transactions with fellow Lloyds Banking Group undertakings
Balances and transactions between members of the Lloyds Bank Group
In accordance with IFRS10 *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.

41 Related party transactions (continued)

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:

	2017 £m	2016 £m
Assets, included within:		
Derivative financial instruments	**7,851**	9,512
Trading and other assets designated at fair value through profit or loss	**603**	963
Loans and receivables: due from fellow Lloyds Banking Group undertakings	**177,420**	148,619
Available-for-sale financial assets	**2,051**	1,872
	187,925	160,966
Liabilities, included within:		
Due to fellow Lloyds Banking Group undertakings	**102,085**	82,545
Trading and other financial liabilities at fair value through profit or loss	**221**	1,273
Derivative financial instruments	**7,528**	8,544
Debt securities in issue	**17,418**	19,670
Subordinated liabilities	**53**	60
	127,305	112,092

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 2017 the Bank earned interest income on the above asset balances of £2,286 million (2016: £2,484 million) and incurred interest expense on the above liability balances of £933 million (2016: £1,025 million).

In addition, the Bank raised recharges of £1,287 million (2016: £922 million) on its subsidiaries in respect of costs incurred and also received fees of £147 million (2016: £135 million), and paid fees of £116 million (2016: £104 million), for various services provided between the Bank and its subsidiaries.

Details of contingent liabilities and commitments entered into on behalf of fellow Lloyds Banking Group undertakings are given in note 42.

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 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	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Assets, included within:				
Loans and receivables: due from fellow Lloyds Banking Group undertakings	**6,195**	5,624	**3,352**	3,641
Trading and other financial assets at fair value through profit or loss	**1,949**	1,911	**–**	577
Derivative financial instruments	**666**	195	**327**	195
	8,810	7,730	**3,679**	4,413
Liabilities, included within:				
Due to fellow Lloyds Banking Group undertakings	**13,237**	5,444	**10,684**	4,258
Derivative financial instruments	**1,384**	1,787	**265**	1,533
Debt securities in issue	**181**	818	**–**	18
Subordinated liabilities	**2,841**	3,815	**2,741**	3,614
	17,643	11,864	**13,690**	9,423

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 2017 the Group earned £62 million and the Bank earned £20 million interest income on the above asset balances (2016: Group £110 million; Bank £56 million); the Group incurred £255 million and the Bank incurred £207 million interest expense on the above liability balances (2016: Group £576 million; Bank £505 million).

During 2017 and 2016 the Bank incurred expenditure for the benefit of its subsidiaries, which has not been recharged.

During the year, the Group disposed of certain entities to fellow subsidiaries of Lloyds Banking Group plc. The ultimate controlling party of these entities remained the same following the transfer.

Other related party transactions
Pension funds
The Group provides banking and some investment management services to certain of its pension funds. At 31 December 2017, customer deposits of £337 million (2016: £171 million) and investment and insurance contract liabilities of £307 million (2016: £406 million), reported within the disposal group (see note 12), related to the Group's pension funds.

41 Related party transactions (continued)

Collective investment vehicles
Through its discontinued operations, the Group manages 134 (2016: 139) collective investment vehicles, such as Open Ended Investment Companies (OEICs), and of these 83 (2016: 83) are consolidated. The Group invested £418 million (2016: £265 million) and redeemed £616 million (2016: £826 million) in the unconsolidated collective investment vehicles during the year and had investments, at fair value, of £2,328 million (2016: £2,405 million) at 31 December. The Group earned fees of £133 million from the unconsolidated collective investment vehicles during 2017 (2016: £192 million).

Joint ventures and associates
At 31 December 2017 there were loans and advances to customers of £123 million (2016: £173 million) outstanding and balances within customer deposits of £9 million (2016: £15 million) relating to joint ventures and associates.

In addition to the above balances, at 31 December 2016 the Group had a number of other associates held by its venture capital business (which it sold during 2017) that it accounted for at fair value through profit or loss. At 31 December 2016, these companies had total assets of approximately £4,712 million, total liabilities of approximately £5,033 million and for the year ended 31 December 2016 had turnover of approximately £4,401 million and made a net loss of £27 million. In addition, the Group had provided £1,550 million of financing to these companies on which it received approximately £127 million of interest income in 2016.

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42 Contingent liabilities and commitments

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

- The European Commission continues to pursue competition investigations against MasterCard and Visa probing, amongst other things, MIFs paid in respect of cards issued outside the EEA.
- Litigation brought by retailers continues in the English Courts against both Visa and MasterCard.
- Any ultimate impact on the Group of the above investigations and litigation against Visa and MasterCard remains uncertain at this time.

Visa Inc completed its acquisition of Visa Europe on 21 June 2016. As part of this transaction, the Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies the allocation of liabilities between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. The maximum amount of liability to which the Group may be subject under the LSA is capped at the cash consideration which was received by the Group at completion. Visa Inc may also have recourse to a general indemnity, previously in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

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

Certain Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling LIBOR and the Australian BBSW Reference Rate. Certain of the plaintiffs' claims, including those in connection with USD and JPY LIBOR, have been dismissed by the US Federal Court for Southern District of New York, and decisions are awaited on the Group's motions to dismiss the Sterling LIBOR and BBSW claims. The decisions leading to the Group's dismissal from the USD LIBOR claims are subject to two appeals; the first took place on 25 September 2017 and a decision is expected in the first quarter of 2018, and the second is expected to take place in the first half of 2018. The decisions leading to the Group's dismissal from the JPY LIBOR claims are not presently subject to appeal.

Certain Group companies are also named as defendants in: (i) UK based claims; and (ii) in a Dutch class action, each raising LIBOR manipulation allegations. A number of the claims against the Group in relation to the alleged mis-sale of Interest Rate Hedging Products also include allegations of LIBOR manipulation.

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

UK shareholder litigation
In August 2014, the Lloyds Banking Group and a number of former directors were named as defendants in a claim by a number of claimants who held shares in Lloyds TSB Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. The defendants refute all claims made. A trial commenced in the English High Court on 18 October 2017 and is scheduled to conclude in the first quarter of 2018 with judgment to follow. It is currently not possible to determine the ultimate impact on the Group (if any).

Financial Services Compensation Scheme
Following the default of a number of deposit takers in 2008, the Financial Services Compensation Scheme (FSCS) borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. In June 2017, the FSCS announced that following the sale of certain Bradford & Bingley mortgage assets, the principal balance outstanding on the HM Treasury loan was £4,678 million (31 December 2016: £15,655 million). Although it is anticipated that the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants, including the Group, of the FSCS. The amount of future levies payable by the Group depends on a number of factors, principally, the amounts recovered by the FSCS from asset sales.

42 Contingent liabilities and commitments (continued)

Tax authorities
The Lloyds Banking Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Lloyds Banking Group that their interpretation of the UK rules which allow the offset of such losses denies the claim. If HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities of approximately £650 million (including interest) and a reduction in the Lloyds Banking Group's deferred tax asset of approximately £350 million (overall impact on the Group of £900 million). The Lloyds Banking Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due. There are a number of other open matters on which the Group is in discussion with HMRC (including the tax treatment of certain costs arising from the divestment of TSB Banking Group plc), none of which is expected to have a material impact on the financial position of the Group.

Residential mortgage repossessions
In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases concerning certain aspects of the Group's practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA is actively engaged with the industry in relation to these considerations and has published Guidance on the treatment of customers with mortgage payment shortfalls. The Guidance covers remediation for mortgage customers who may have been affected by the way firms calculate these customers' monthly mortgage instalments. The Group is now determining its detailed approach to implementation of the Guidance and will contact affected customers during 2018.

Mortgage arrears handling activities
On 26 May 2016, the Group was informed that an enforcement team at the FCA had commenced an investigation in connection with the Group's mortgage arrears handling activities. This investigation is ongoing and it is currently not possible to make a reliable assessment of the liability, if any, that may result from the investigation.

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

Contingent liabilities and commitments arising from the banking business

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Contingent liabilities				
Acceptances and endorsements	**71**	21	**70**	20
Other:				
Other items serving as direct credit substitutes	**740**	779	**722**	760
Performance bonds and other transaction-related contingencies	**2,300**	2,237	**2,167**	2,091
	3,040	3,016	**2,889**	2,851
Total contingent liabilities	**3,111**	3,037	**2,959**	2,871

	The Bank	
	2017 £m	2016 £m
Incurred on behalf of fellow Lloyds Banking Group undertakings	**5**	5

42 Contingent liabilities and commitments (continued)

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.

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Commitments				
Forward asset purchases and forward deposits placed	**384**	648	**353**	620
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year original maturity:				
Mortgage offers made	**11,156**	10,749	**1,291**	697
Other commitments	**81,793**	62,697	**34,462**	37,974
	92,949	73,446	**35,753**	38,671
1 year or over original maturity	**36,386**	40,074	**33,305**	36,375
Total commitments	**129,719**	114,168	**69,411**	75,666

	The Bank	
	2017 £m	2016 £m
Incurred on behalf of fellow Lloyds Banking Group undertakings	**1,532**	5,274

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £60,126 million (2016: £63,203 million) for the Group and £42,010 million (2016: £45,976 million) for the Bank were irrevocable.

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Not later than 1 year	**275**	264	**153**	141
Later than 1 year and not later than 5 years	**845**	855	**478**	461
Later than 5 years	**934**	944	**462**	429
Total operating lease commitments	**2,054**	2,063	**1,093**	1,031

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

Capital commitments
Excluding commitments of the Group in respect of investment property (notes 12 and 23), capital expenditure contracted but not provided for at 31 December 2017 amounted to £444 million (2016: £543 million) for the Group and £4 million (2016: £2 million) for the Bank. Of this amount for the Group, £440 million (2016: £541 million) relates to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

43 Financial instruments

(1) Measurement basis of financial assets and liabilities

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

		At fair value through profit or loss						
The Group	**Derivatives designated as hedging instruments £m**	**Held for trading £m**	**Designated upon initial recognition £m**	**Available-for-sale £m**	**Loans and receivables £m**	**Held at amortised cost £m**	**Insurance contracts £m**	**Total £m**
At 31 December 2017								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	58,521	–	58,521
Items in the course of collection from banks	–	–	–	–	–	755	–	755
Trading and other financial assets at fair value through profit or loss	–	42,830	2,778	–	–	–	–	45,608
Derivative financial instruments	1,900	22,252	–	–	–	–	–	24,152
Loans and receivables:								
Loans and advances to banks	–	–	–	–	4,274	–	–	4,274
Loans and advances to customers	–	–	–	–	465,555	–	–	465,555
Debt securities	–	–	–	–	3,637	–	–	3,637
Due from fellow Lloyds Banking group undertakings	–	–	–	–	6,195	–	–	6,195
	–	–	–	–	479,661	–	–	479,661
Available-for-sale financial assets	–	–	–	41,717	–	–	–	41,717
Assets of continuing operations	1,900	65,082	2,778	41,717	479,661	59,276	–	650,414
Assets in the disposal group (note 12)	–	3,465	125,051	–	2,337	–	–	130,853
Total financial assets	1,900	68,547	127,829	41,717	481,998	59,276	0	781,267
Financial liabilities								
Deposits from banks	–	–	–	–	–	28,888	–	28,888
Customer deposits	–	–	–	–	–	418,124	–	418,124
Due to fellow Lloyds Banking group undertakings	–	–	–	–	–	13,237	–	13,237
Items in course of transmission to banks	–	–	–	–	–	579	–	579
Trading and other financial liabilities at fair value through profit or loss	–	43,062	7,812	–	–	–	–	50,874
Derivative financial instruments	1,864	22,835	–	–	–	–	–	24,699
Notes in circulation	–	–	–	–	–	1,313	–	1,313
Debt securities in issue	–	–	–	–	–	61,865	–	61,865
Subordinated liabilities	–	–	–	–	–	14,782	–	14,782
Liabilities of continuing operations	1,864	65,897	7,812	–	–	538,788	–	614,361
Liabilities in the disposal group (note 12)	–	3,147	–	–	–	5,055	119,271	127,473
Total financial liabilities	1,864	69,044	7,812	–	–	543,843	119,271	741,834

43 Financial instruments (continued)

The Group	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2016								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	47,452	–	47,452
Items in the course of collection from banks	–	–	–	–	–	706	–	706
Trading and other financial assets at fair value through profit or loss	–	45,824	5,374	–	–	–	–	51,198
Derivative financial instruments	2,712	31,147	–	–	–	–	–	33,859
Loans and receivables:								
Loans and advances to banks	–	–	–	–	5,583	–	–	5,583
Loans and advances to customers	–	–	–	–	451,282	–	–	451,282
Debt securities	–	–	–	–	3,397	–	–	3,397
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	5,624	–	–	5,624
	–	–	–	–	465,886	–	–	465,886
Available-for-sale financial assets	–	–	–	56,524	–	–	–	56,524
Assets of continuing operations	2,712	76,971	5,374	56,524	465,886	48,158	–	655,625
Assets in the disposal group (note 12)	–	3,800	109,687	–	21,319	–	–	134,806
Total financial assets	2,712	80,771	115,061	56,524	487,205	48,158	–	790,431
Financial liabilities								
Deposits from banks	–	–	–	–	–	15,690	–	15,690
Customer deposits	–	–	–	–	–	415,460	–	415,460
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	5,444	–	5,444
Items in course of transmission to banks	–	–	–	–	–	548	–	548
Trading and other financial liabilities at fair value through profit or loss	–	45,079	9,425	–	–	–	–	54,504
Derivative financial instruments	2,254	31,642	–	–	–	–	–	33,896
Notes in circulation	–	–	–	–	–	1,402	–	1,402
Debt securities in issue	–	–	–	–	–	74,733	–	74,733
Subordinated liabilities	–	–	–	–	–	17,258	–	17,258
Liabilities of continuing operations	2,254	76,721	9,425	–	–	530,535	–	618,935
Liabilities in the disposal group (note 12)	–	3,008	–	–	–	4,809	114,764	122,581
Total financial liabilities	2,254	79,729	9,425	–	–	535,344	114,764	741,516

43 Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2017							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	55,835	55,835
Items in the course of collection from banks	–	–	–	–	–	490	490
Trading and other financial assets at fair value through profit or loss	–	42,839	1,138	–	–	–	43,977
Derivative financial instruments	774	25,990	–	–	–	–	26,764
Loans and receivables:							
Loans and advances to banks	–	–	–	–	3,611	–	3,611
Loans and advances to customers	–	–	–	–	170,804	–	170,804
Debt securities	–	–	–	–	3,182	–	3,182
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	180,772	–	180,772
	–	–	–	–	358,369	–	358,369
Available-for-sale financial assets	–	–	–	42,566	–	–	42,566
Total financial assets	774	68,829	1,138	42,566	358,369	56,325	528,001
Financial liabilities							
Deposits from banks	–	–	–	–	–	7,538	7,538
Customer deposits	–	–	–	–	–	234,397	234,397
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	112,769	112,769
Items in course of transmission to banks	–	–	–	–	–	304	304
Trading and other financial liabilities at fair value through profit or loss	–	43,233	7,812	–	–	–	51,045
Derivative financial instruments	2,079	26,188	–	–	–	–	28,267
Debt securities in issue	–	–	–	–	–	66,249	66,249
Subordinated liabilities	–	–	–	–	–	9,341	9,341
Total financial liabilities	2,079	69,421	7,812	–	–	430,598	509,910

43 Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2016							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	44,595	44,595
Items in the course of collection from banks	–	–	–	–	–	512	512
Trading and other financial assets at fair value through profit or loss	–	46,787	1,522	–	–	–	48,309
Derivative financial instruments	1,072	35,642	–	–	–	–	36,714
Loans and receivables:							
Loans and advances to banks	–	–	–	–	4,379	–	4,379
Loans and advances to customers	–	–	–	–	161,161	–	161,161
Debt securities	–	–	–	–	2,818	–	2,818
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	152,260	–	152,260
	–	–	–	–	320,618	–	320,618
Available-for-sale financial assets	–	–	–	55,122	–	–	55,122
Total financial assets	1,072	82,429	1,522	55,122	320,618	45,107	505,870
Financial liabilities							
Deposits from banks	–	–	–	–	–	9,450	9,450
Customer deposits	–	–	–	–	–	213,135	213,135
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	86,803	86,803
Items in course of transmission to banks	–	–	–	–	–	292	292
Trading and other financial liabilities at fair value through profit or loss	–	46,353	9,423	–	–	–	55,776
Derivative financial instruments	2,760	35,831	–	–	–	–	38,591
Debt securities in issue	–	–	–	–	–	74,366	74,366
Subordinated liabilities	–	–	–	–	–	10,575	10,575
Total financial liabilities	2,760	82,184	9,423	–	–	394,621	488,988

(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 at a specific date and may be significantly different from the amount which will actually be paid or received on maturity or settlement date.

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

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

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

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

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

43 Financial instruments (continued)

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

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

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

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

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

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

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

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

43 Financial instruments (continued)

(3) Financial assets and liabilities carried at fair value
Critical accounting estimates and judgments
The valuation techniques for level 2 and, particularly, 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 this note on page 113. Further details of the Group's level 3 financial instruments and the sensitivity of their valuation including the effect of applying reasonably possible alternative assumptions in determining their fair value are set out below.

(A) Financial assets, excluding derivatives
Valuation hierarchy
At 31 December 2017, the Group's financial assets carried at fair value, excluding derivatives, totalled £87,325 million (31 December 2016: £107,722 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 103). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

Valuation hierarchy

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	30,568	–	30,568
Loans and advances to banks	–	1,614	–	1,614
Debt securities:				
Government securities	9,836	928	–	10,764
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	222	–	222
Asset-backed securities:				
Mortgage-backed securities	–	189	–	189
Other asset-backed securities	–	95	–	95
Corporate and other debt securities	–	2,088	–	2,088
	9,836	3,522	–	13,358
Equity shares	–	–	50	50
Treasury and other bills	18	–	–	18
Total trading and other financial assets at fair value through profit or loss	9,854	35,704	50	45,608
Available-for-sale financial assets				
Debt securities:				
Government securities	34,534	174	–	34,708
Bank and building society certificates of deposit	–	167	–	167
Asset-backed securities:				
Mortgage-backed securities	–	1,156	–	1,156
Other asset-backed securities	–	163	92	255
Corporate and other debt securities	229	4,386	–	4,615
	34,763	6,046	92	40,901
Equity shares	555	38	223	816
Total available-for-sale financial assets	35,318	6,084	315	41,717
Total financial assets carried at fair value, excluding derivatives	45,172	41,788	365	87,325

43 Financial instruments (continued)

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017 – Disposal group				
Trading and other financial assets at fair value through profit or loss				
Debt securities:				
Government securities	**10,435**	**801**	**23**	**11,259**
Other public sector securities	**–**	**1,526**	**1**	**1,527**
Asset-backed securities:				
Mortgage-backed securities	**3**	**159**	**49**	**211**
Other asset-backed securities	**7**	**6,889**	**785**	**7,681**
Corporate and other debt securities	**–**	**18,178**	**16**	**18,194**
	10,445	**27,553**	**874**	**38,872**
Equity shares	**85,289**	**18**	**872**	**86,179**
Total financial assets carried at fair value, excluding derivatives	**95,734**	**27,571**	**1,746**	**125,051**

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2016				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	31,050	–	31,050
Loans and advances to banks	–	2,606	–	2,606
Debt securities:				
Government securities	12,005	950	–	12,955
Bank and building society certificates of deposit	–	244	–	244
Asset-backed securities:				
Mortgage-backed securities	–	47	–	47
Other asset-backed securities	–	69	–	69
Corporate and other debt securities	112	1,764	1,745	3,621
	12,117	3,074	1,745	16,936
Equity shares	26	–	560	586
Treasury and other bills	20	–	–	20
Total trading and other financial assets at fair value through profit or loss	12,163	36,730	2,305	51,198
Available-for-sale financial assets				
Debt securities:				
Government securities	48,542	172	–	48,714
Bank and building society certificates of deposit	–	142	–	142
Asset-backed securities:				
Mortgage-backed securities	–	108	–	108
Other asset-backed securities	–	184	133	317
Corporate and other debt securities	107	5,923	–	6,030
	48,649	6,529	133	55,311
Equity shares	435	17	761	1,213
Total available-for-sale financial assets	49,084	6,546	894	56,524
Total financial assets carried at fair value, excluding derivatives	61,247	43,276	3,199	107,722

43 Financial instruments (continued)

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2016 – Disposal group				
Trading and other financial assets at fair value through profit or loss				
Debt securities:				
Government securities	12,954	822	–	13,776
Other public sector securities	–	1,278	46	1,324
Asset-backed securities:				
Mortgage-backed securities	–	607	53	660
Other asset-backed securities	4	7,367	442	7,813
Corporate and other debt securities	–	18,529	8	18,537
	12,958	28,603	549	42,110
Equity shares	66,588	37	952	67,577
Total financial assets carried at fair value, excluding derivatives	79,546	28,640	1,501	109,687

Valuation hierarchy

The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
At 31 December 2017				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	**–**	**30,568**	**–**	**30,568**
Loans and advances to banks	**–**	**1,614**	**–**	**1,614**
Debt securities:				
Government securities	**9,834**	**928**	**–**	**10,762**
Asset-backed securities:				
Mortgage-backed securities	**–**	**189**	**–**	**189**
Other asset-backed securities	**–**	**95**	**–**	**95**
Corporate and other debt securities	**–**	**749**	**–**	**749**
	9,834	**1,961**	**–**	**11,795**
Equity shares	**–**	**–**	**–**	**–**
Treasury and other bills	**–**	**–**	**–**	**–**
Total trading and other financial assets at fair value through profit or loss	**9,834**	**34,143**	**–**	**43,977**
Available-for-sale financial assets				
Debt securities:				
Government securities	**34,397**	**174**	**–**	**34,571**
Bank and building society certificates of deposit	**–**	**167**	**–**	**167**
Asset-backed securities:				
Mortgage-backed securities	**–**	**1,129**	**–**	**1,129**
Other asset-backed securities	**–**	**65**	**–**	**65**
Corporate and other debt securities	**221**	**5,650**	**–**	**5,871**
	34,618	**7,185**	**–**	**41,803**
Equity shares	**555**	**6**	**202**	**763**
Total available-for-sale financial assets	**35,173**	**7,191**	**202**	**42,566**
Total financial assets carried at fair value, excluding derivatives	**45,007**	**41,334**	**202**	**86,543**

43 Financial instruments (continued)

Valuation hierarchy

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2016				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	31,993	–	31,993
Loans and advances to banks	–	2,606	–	2,606
Debt securities:				
Government securities	12,005	950	–	12,955
Asset-backed securities:				
Mortgage-backed securities	–	47	–	47
Other asset-backed securities	–	69	–	69
Corporate and other debt securities	113	448	78	639
	12,118	1,514	78	13,710
Equity shares	–	–	–	–
Total trading and other financial assets at fair value through profit or loss	12,118	36,113	78	48,309
Available-for-sale financial assets				
Debt securities:				
Government securities	48,406	170	–	48,576
Bank and building society certificates of deposit	–	142	–	142
Asset-backed securities:				
Mortgage-backed securities	–	71	–	71
Other asset-backed securities	–	127	–	127
Corporate and other debt securities	104	5,371	–	5,475
	48,510	5,881	–	54,391
Equity shares	434	6	291	731
Total available-for-sale financial assets	48,944	5,887	291	55,122
Total financial assets carried at fair value, excluding derivatives	61,062	42,000	369	103,431

43 Financial instruments (continued)

Movements in level 3 portfolio

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

	2017			2016		
The Group – Continuing operations	**Trading and other financial assets at fair value through profit or loss £m**	**Available-for-sale £m**	**Total financial assets, excluding derivatives £m**	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Total financial assets, excluding derivatives £m
At 1 January	**2,305**	**894**	**3,199**	5,116	684	5,800
Exchange and other adjustments	**–**	**(25)**	**(25)**	8	12	20
Gains recognised in the income statement within other income	**80**	**–**	**80**	437	–	437
(Losses) gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	**–**	**(125)**	**(125)**	–	312	312
Purchases	**228**	**36**	**264**	833	258	1,091
Sales	**(483)**	**(52)**	**(535)**	(2,597)	(527)	(3,124)
Disposal of businesses	**(2,061)**	**(375)**	**(2,436)**	–	–	–
Transfers into the level 3 portfolio	**–**	**1**	**1**	186	155	341
Transfers out of the level 3 portfolio	**(19)**	**(39)**	**(58)**	(177)	–	(177)
Transferred to disposal group (see note 12)	**–**	–	**–**	(1,501)	–	(1,501)
At 31 December	**50**	**315**	**365**	2,305	894	3,199
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**6**	**–**	**6**	642[1]	–	642

[1] Included £304 million which related to discontinued operations.

The Group – Discontinued operations	**Trading and other financial assets at fair value through profit or loss £m**
At 1 January 2017	**1,501**
Exchange and other adjustments	**–**
Gains recognised in the income statement within other income	**87**
Purchases	**427**
Sales	**(209)**
Transfers into the level 3 portfolio	**155**
Transfers out of the level 3 portfolio	**(215)**
At 31 December 2017	**1,746**
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December 2017	**47**

43 Financial instruments (continued)

The Bank	2017 Trading and other financial assets at fair value through profit or loss £m	2017 Available-for-sale £m	2017 Total financial assets, excluding derivatives £m	2016 Trading and other financial assets at fair value through profit or loss £m	2016 Available-for-sale £m	2016 Total financial assets, excluding derivatives £m
At 1 January	**78**	**291**	**369**	89	290	379
Exchange and other adjustments	**–**	**(17)**	**(17)**	–	8	8
Gains (losses) recognised in the income statement within other income	**5**	**–**	**5**	(1)	–	(1)
(Losses) gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	**–**	**(72)**	**(72)**	–	281	281
Purchases	**–**	**–**	**–**	–	156	156
Sales	**(64)**	**–**	**(64)**	(10)	(485)	(495)
Transfers into the level 3 portfolio	**–**	**–**	**–**	–	41	41
Transfers out of the level 3 portfolio	**(19)**	**–**	**(19)**	–	–	–
At 31 December	**–**	**202**	**202**	78	291	369
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**5**	**–**	**5**	(1)	–	(1)

Valuation methodology for financial assets, excluding derivatives

Loans and advances to customers and banks

These assets are principally reverse repurchase agreements. The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security purchased under the reverse repurchase agreement.

Debt securities

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

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

Equity investments

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

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

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

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

43 Financial instruments (continued)

(B) Financial liabilities, excluding derivatives

Valuation hierarchy

At 31 December 2017, the Group's financial liabilities carried at fair value, excluding derivatives, comprised its trading and other financial liabilities at fair value through profit or loss and totalled £50,874 million (31 December 2016: £54,504 million) (Financial guarantees are also recognised at fair value, on initial recognition, and are classified as level 3; but the balance is not material). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 103). 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 2017				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	**–**	**7,812**	**–**	**7,812**
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**–**	**41,378**	**–**	**41,378**
Other deposits	**–**	**381**	**–**	**381**
Short positions in securities	**1,106**	**197**	**–**	**1,303**
	1,106	**41,956**	**–**	**43,062**
Total financial liabilities carried at fair value, excluding derivatives	**1,106**	**49,768**	**–**	**50,874**

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2016				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	–	9,423	2	9,425
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	42,067	–	42,067
Other deposits	–	530	–	530
Short positions in securities	2,417	65	–	2,482
	2,417	42,662	–	45,079
Total financial liabilities carried at fair value, excluding derivatives	2,417	52,085	2	54,504

43 Financial instruments (continued)

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	**–**	**7,812**	**–**	**7,812**
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**–**	**41,378**	**–**	**41,378**
Other deposits	**–**	**552**	**–**	**552**
Short positions in securities	**1,106**	**197**	**–**	**1,303**
	1,106	**42,127**	**–**	**43,233**
Total financial liabilities carried at fair value, excluding derivatives	**1,106**	**49,939**	**–**	**51,045**

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2016				
Trading and other financial liabilities at fair value through profit or loss	–	9,423	–	9,423
Liabilities held at fair value through profit or loss				
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	43,011	–	43,011
Other deposits	–	860	–	860
Short positions in securities	2,417	65	–	2,482
	2,417	43,936	–	46,353
Total financial liabilities carried at fair value, excluding derivatives	2,417	53,359	–	55,776

The table below analyses movements in level 3 financial liabilities excluding derivatives. There were no transfers into or out of Level 3 during 2016 or 2017.

The Group	2017 £m	2016 £m
At 1 January	**2**	1
Losses recognised in the income statement within other income	**(2)**	1
At 31 December	**–**	2
Losses recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December	**–**	1

43 Financial instruments (continued)

Valuation methodology for financial liabilities, excluding derivatives

Liabilities held at fair value through profit or loss

These principally comprise debt securities in issue which are classified as level 2 and their fair value is determined using techniques whose inputs are based on observable market data. The carrying amount of the securities is adjusted to reflect the effect of changes in own credit spreads. From 1 January 2017, the resulting gain or loss is recognised in other comprehensive income (see note 1).

At 31 December 2017, the own credit adjustment arising from the fair valuation of £7,812 million (2016: £9,423 million) of the Group's debt securities in issue designated at fair value through profit or loss resulted in a loss of £55 million, recognised in other comprehensive income (2016: loss of £28 million, recognised in the income statement).

Trading liabilities in respect of securities sold under repurchase agreements

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

(C) Derivatives

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2017, such assets totalled £24,152 million for the Group and £26,764 million for the Bank (31 December 2016: £33,859 million for the Group and £36,714 million for the Bank) and liabilities totalled £24,699 million for the Group and £28,267 million for the Bank (31 December 2016: £33,896 million for the Group and £38,591 million for the Bank). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 103). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

	2017				2016			
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	**1**	**23,095**	**1,056**	**24,152**	2	32,458	1,399	33,859
Derivative liabilities	**(2)**	**(23,893)**	**(804)**	**(24,699)**	(3)	(32,933)	(960)	(33,896)

	2017				2016			
Disposal 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	**245**	**3,220**	**–**	**3,465**	267	3,533	–	3,800
Derivative liabilities	**(585)**	**(2,562)**	**–**	**(3,147)**	(355)	(2,653)	–	(3,008)

	2017				2016			
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	**1**	**26,127**	**636**	**26,764**	2	35,895	817	36,714
Derivative liabilities	**(2)**	**(27,515)**	**(750)**	**(28,267)**	3	37,684	904	38,591

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

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

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

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

Certain unobservable inputs are used to calculate CVA, FVA, and own credit adjustments, but are not considered significant in determining the classification of the derivative and debt portfolios. Consequently, those inputs do not form part of the Level 3 sensitivities presented.

43 Financial instruments (continued)

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

	2017		2016	
The Group	**Derivative assets £m**	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	**1,399**	**(960)**	924	(723)
Exchange and other adjustments	**24**	**(20)**	74	(53)
(Losses) gains recognised in the income statement within other income	**(208)**	**215**	289	(299)
Purchases (additions)	**103**	**(18)**	24	(13)
(Sales) redemptions	**(79)**	**53**	(91)	128
Transfers into the level 3 portfolio	**33**	**(74)**	216	–
Transfers out of the level 3 portfolio	**(216)**	**–**	(37)	–
At 31 December	**1,056**	**(804)**	1,399	(960)
(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	**(208)**	**213**	284	(262)

	2017		2016	
The Bank	**Derivative assets £m**	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	**817**	**(904)**	579	(685)
Exchange and other adjustments	**7**	**(19)**	25	(51)
(Losses) gains recognised in the income statement within other income	**(76)**	**212**	146	(283)
Purchases (additions)	**103**	**(18)**	24	(13)
(Sales) redemptions	**(75)**	**53**	(91)	128
Transfers into the level 3 portfolio	**33**	**(74)**	172	–
Transfers out of the level 3 portfolio	**(173)**	**–**	(38)	–
At 31 December	**636**	**(750)**	817	(904)
(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	**(76)**	**211**	141	(246)

Derivative valuation adjustments

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

(i) Uncollateralised derivative valuation adjustments, excluding monoline counterparties

The following table summarises the movement on this valuation adjustment account for the Group during 2016 and 2017.

	2017 £m	2016 £m
At 1 January	**744**	598
Income statement (credit) charge	**(260)**	163
Transfers	**37**	(17)
At 31 December	**521**	744

Represented by:

	2017 £m	2016 £m
Credit Valuation Adjustment	**408**	685
Debit Valuation Adjustment	**(37)**	(123)
Funding Valuation Adjustment	**150**	182
	521	744

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

43 Financial instruments (continued)

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

The CVA is sensitive to:

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

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

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

The combination of a one notch deterioration in the credit rating of derivative counterparties and a ten per cent increase in LGD increases the CVA by £82 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 2017).

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 £96 million to £133 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A one per cent rise in interest rates would lead to a £186 million fall in the overall valuation adjustment to £185 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 £26 million.

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

At 31 December 2017, the Group's derivative trading business held mid to bid-offer valuation adjustments of £74 million (2016: £96 million).

43 Financial instruments (continued)

(D) Sensitivity of level 3 valuations

	Valuation basis/technique	Significant unobservable inputs[1]	At 31 December 2017 Carrying value £m	At 31 December 2017 Effect of reasonably possible alternative assumptions[2] Favourable changes £m	At 31 December 2017 Effect of reasonably possible alternative assumptions[2] Unfavourable changes £m	At 31 December 2016 Carrying value £m	At 31 December 2016 Effect of reasonably possible alternative assumptions Favourable changes £m	At 31 December 2016 Effect of reasonably possible alternative assumptions Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss:								
Debt securities	Discounted cash flows	Credit spreads (bps) (1 bps/2 bps)	–	–	–	29	5	(5)
Asset-backed securities	Lead manager or broker quote	n/a	–	–	–	59	–	–
Equity and venture capital investments	Market approach	Earnings multiple (0.9/10.0)	–	–	–	2,163	63	(68)
	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**50**	**5**	**(5)**	54	2	(3)
			50			2,305		
Available-for-sale financial assets								
Asset-backed securities	Lead manager or broker quote/consensus pricing	n/a	**92**	–	**(4)**	133	–	–
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**223**	**50**	**(4)**	761	48	(53)
			315			894		
Derivative financial assets								
Interest rate derivatives	Option pricing model	Interest rate volatility (9%/94%)	**1,056**	**11**	**(3)**	1,399	(3)	(19)
			1,056			1,399		
Level 3 financial assets carried at fair value			**1,421**			4,598		
Trading and other financial liabilities at fair value through profit or loss			–	–	–	2	–	–
Derivative financial liabilities								
Interest rate derivatives	Option pricing model	Interest rate volatility (9%/94%)	**804**	–	–	960	–	–
			804			960		
Level 3 financial liabilities carried at fair value			**804**			962		

[1] Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.

[2] Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

[3] Underlying asset/net asset values represent fair value.

43 Financial instruments (continued)

Disposal group	Valuation basis/technique	Significant unobservable inputs[1]	At 31 December 2017 Carrying value £m	At 31 December 2017 Effect of reasonably possible alternative assumptions[2] Favourable changes £m	At 31 December 2017 Effect of reasonably possible alternative assumptions[2] Unfavourable changes £m	At 31 December 2016 Carrying value £m	At 31 December 2016 Effect of reasonably possible alternative assumptions[2] Favourable changes £m	At 31 December 2016 Effect of reasonably possible alternative assumptions[2] Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss:								
Unlisted equities, debt securities and property partnerships in the life funds	Underlying asset/ net asset value (incl. property prices), broker quotes or discounted cashflows[3]	n/a	1,746	26	(76)	1,501	–	(32)
Level 3 financial assets carried at fair value			1,746			1,501		

[1] Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.

[2] Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

[3] Underlying asset/net asset values represent fair value.

Unobservable inputs

Significant unobservable inputs affecting the valuation of debt securities, unlisted equity investments and derivatives are as follows:

– Interest rates and inflation rates are referenced in some derivatives where the payoff that the holder of the derivative receives depends on the behaviour of those underlying references through time.
– Credit spreads represent the premium above the benchmark reference instrument required to compensate for lower credit quality; higher spreads lead to a lower fair value.
– Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes.
– Earnings multiples are used to value certain unlisted equity investments; a higher earnings multiple will result in a higher fair value.

Reasonably possible alternative assumptions

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

Debt securities

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

Derivatives

Reasonably possible alternative assumptions have been determined in respect of swaptions in the Group's derivative portfolios which are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities have been flexed within a range of 9 per cent to 94 per cent (2016: nil per cent and 115 per cent).

Unlisted equity, venture capital investments and investments in property partnerships

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

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

43 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 103). Loans and receivables are mainly classified as level 3 due to significant unobservable inputs used in the valuation models. Where inputs are observable, debt securities are classified as level 1 or 2.

			Valuation hierarchy		
The Group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2017				–	
Loans and advances to customers	**465,555**	**465,268**	**–**	**16,832**	**448,436**
Loans and advances to banks	**4,274**	**4,261**	**–**	**94**	**4,167**
Debt securities	**3,637**	**3,580**	**–**	**3,571**	**9**
Due from fellow Lloyds Banking Group undertakings	**6,195**	**6,195**	**–**	**–**	**6,195**
Reverse repos included in above amounts:					
Loans and advances to customers	**16,832**	**16,832**	**–**	**16,832**	**–**
Loans and advances to banks	**94**	**94**	**–**	**94**	**–**
At 31 December 2016					
Loans and advances to customers	451,282	451,117	–	–	451,117
Loans and advances to banks	5,583	5,553	–	–	5,553
Debt securities	3,397	3,303	–	3,288	15
Due from fellow Lloyds Banking Group undertakings	5,624	5,624	–	–	5,624
Reverse repos included in above amounts:				–	
Loans and advances to customers	8,304	8,304	–		8,304
Loans and advances to banks	437	437	–	–	437

			Valuation hierarchy		
Disposal group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2017					
Loans and advances to banks	**2,337**	**2,303**	**–**	**677**	**1,626**
Due from fellow Lloyds Banking Group undertakings	**1,721**	**1,721**	**–**	**–**	**1,721**
Reverse repos included in above amounts:					
Loans and advances to banks	**677**	**677**	**–**	**677**	**–**
At 31 December 2016					
Loans and advances to banks	21,319	21,259	–	–	21,259
Due from fellow Lloyds Banking Group undertakings	2,015	2,015	–	–	2,015
Reverse repos included in above amounts:					
Loans and advances to banks	465	465	–	–	465

43 Financial instruments (continued)

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2017					
Loans and advances to customers	**170,804**	**168,560**	**–**	**16,832**	**151,728**
Loans and advances to banks	**3,611**	**3,603**	**–**	**94**	**3,509**
Debt securities	**3,182**	**3,182**	**–**	**3,182**	**–**
Due from fellow Lloyds Banking Group undertakings	**180,772**	**180,772**	**–**	**–**	**180,772**
Reverse repos included in above amounts:					
Loans and advances to customers	**16,832**	**16,832**	**–**	**16,832**	**–**
Loans and advances to banks	**94**	**94**	**–**	**94**	**–**
At 31 December 2016					
Loans and advances to customers	161,161	159,572	–	–	159,572
Loans and advances to banks	4,379	4,358	–	–	4,358
Debt securities	2,818	2,818	–	2,818	–
Due from fellow Lloyds Banking Group undertakings	152,260	152,260	–	–	152,260
Reverse repos included in above amounts:					
Loans and advances to customers	8,304	8,304	–	–	8,304
Loans and advances to banks	437	437	–	–	437

Valuation methodology

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

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

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

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

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

43 Financial instruments (continued)

(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 103).

The Group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2017					
Deposits from banks	**28,888**	**28,883**	**–**	**28,883**	**–**
Customer deposits	**418,124**	**418,413**	**–**	**411,563**	**6,850**
Due to fellow Lloyds Banking Group undertakings	**13,237**	**13,237**	**–**	**13,237**	**–**
Debt securities in issue	**61,865**	**64,790**	**–**	**64,790**	**–**
Subordinated liabilities	**14,782**	**17,288**	**–**	**17,288**	**–**
Repos included in above amounts:					
Deposits from banks	**23,175**	**23,175**	**–**	**23,175**	**–**
Customer deposits	**2,638**	**2,638**	**–**	**2,638**	**–**
At 31 December 2016					
Deposits from banks	15,690	15,679	–	15,679	–
Customer deposits	415,460	416,490	–	408,571	7,919
Due to fellow Lloyds Banking Group undertakings	5,444	5,444	–	5,444	–
Debt securities in issue	74,733	77,198	–	76,982	216
Subordinated liabilities	17,258	19,280	–	19,280	–
Repos included in above amounts:					
Deposits from banks	7,279	7,279	–	7,279	–
Customer deposits	2,462	2,462	–	2,462	–

Disposal group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2017					
Deposits from banks	**916**	**916**	**–**	**916**	**–**
Due to fellow Lloyds Banking Group undertakings	**2,063**	**2,063**	**–**	**2,063**	**–**
Debt securities in issue	**1,794**	**1,794**	**–**	**1,794**	**–**
Subordinated liabilities	**2,345**	**2,345**	**–**	**2,345**	**–**
Repos included in above amounts:					
Deposits from banks	**–**	**–**	**–**	**–**	**–**
At 31 December 2016					
Deposits from banks	695	716	–	716	–
Due to fellow Lloyds Banking Group undertakings	2,386	2,386	–	2,386	–
Debt securities in issue	1,746	1,746	–	1,746	–
Subordinated liabilities	2,368	2,368	–	2,368	–
Repos included in above amounts:					
Deposits from banks	–	–	–	–	–

43 Financial instruments (continued)

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2017					
Deposits from banks	**7,538**	**7,536**	**–**	**7,536**	**–**
Customer deposits	**234,397**	**234,512**	**–**	**234,512**	**–**
Due to fellow Lloyds Banking Group undertakings	**112,769**	**112,769**	**–**	**112,769**	**–**
Debt securities in issue	**66,249**	**68,807**	**–**	**68,807**	**–**
Subordinated liabilities	**9,341**	**10,860**	**–**	**10,860**	**–**
Repos included in above amounts:					
Deposits from banks	**3,198**	**3,198**	**–**	**3,198**	**–**
Customer deposits	**2,637**	**2,637**	**–**	**2,637**	**–**
At 31 December 2016					
Deposits from banks	9,450	9,437	–	9,437	–
Customer deposits	213,135	213,455	–	213,455	–
Due to fellow Lloyds Banking Group undertakings	86,803	86,803	–	86,803	–
Debt securities in issue	74,366	77,767	–	77,767	–
Subordinated liabilities	10,575	11,971	–	11,971	–
Repos included in above amounts:					
Deposits from banks	2,758	2,758	–	2,758	–
Customer deposits	2,462	2,462	–	2,462	–

Valuation methodology

Deposits from banks and customer deposits

The fair value of bank and customer deposits repayable on demand is assumed to be equal to their carrying value.

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

Debt securities in issue

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

Subordinated liabilities

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

Repurchase agreements

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

(5) Reclassifications of financial assets

There have been no reclassifications of financial assets in 2017.

During 2016, the Group reassessed its holding of government securities classified as held-to-maturity in light of the low interest rate environment at that time and they were reclassified as available-for-sale; this resulted in a credit of £1,544 million to the available-for-sale revaluation reserve (£1,127 million after tax) for both the Group and the Bank.

44 Transfers of financial assets

There were no significant transferred financial assets which were derecognised in their entirety, but with ongoing exposure. Details of transferred financial assets that continue to be recognised in full are as follows.

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

As set out in note 16, included within loans and receivables are loans transferred under the Group's securitisation and covered bond programmes. As the Group retains all of a majority of the risks and rewards associated with these loans, including credit, interest rate, prepayment and liquidity risk, they remain on the Group's balance sheet. Assets transferred into the Group's securitisation and covered bond programmes are not available to be used by the Group whilst the assets are within the programmes. However, the Group retains the right to remove loans from the covered bond programmes where they are in excess of the programme's requirements. In addition, where the Group has retained some of the notes issued by securitisation and covered bond programmes, the Group has the ability to sell or pledge these retained notes.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For repurchase and securities lending transactions, the associated liabilities represent the Group's obligation to repurchase the transferred assets. For securitisation programmes, the associated liabilities represent the external notes in issue (note 28). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

	The Group		**The Bank**	
	Carrying value of transferred assets £m	**Carrying value of associated liabilities £m**	**Carrying value of transferred assets £m**	**Carrying value of associated liabilities £m**
At 31 December 2017				
Repurchase and securities lending transactions				
Trading and other financial assets at fair value through profit or loss	**4,643**	**3,257**	**4,636**	**3,257**
Available-for-sale financial assets	**19,359**	**16,753**	**19,220**	**16,753**
Loans and receivables:				
Loans and advances to customers	–	–	–	–
Securitisation programmes				
Loans and receivables:				
Loans and advances to customers[1,2]	**35,475**	**3,730**	**9,640**	**779**

	The Group		The Bank	
	Carrying value of transferred assets £m	Carrying value of associated liabilities £m	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
At 31 December 2016				
Repurchase and securities lending transactions				
Trading and other financial assets at fair value through profit or loss	4,806	3,380	5,165	3,763
Available-for-sale financial assets	24,681	21,809	24,659	21,809
Loans and receivables:				
Loans and advances to customers	583	–	583	–
Securitisation programmes				
Loans and receivables:				
Loans and advances to customers[1,2]	52,184	7,937	10,301	501

[1] The carrying value of associated liabilities for the Group excludes securitisation notes held by the Group of £21,466 million (31 December 2016: £25,751 million).

[2] The carrying value of transferred assets for the Bank includes amounts relating to assets transferred to structured entities which are fully consolidated into the Group. The liabilities associated with such assets are issued by the structured entities.

45 Offsetting of financial assets and liabilities

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

At 31 December 2017	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/ pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	14,018	–	14,018	–	(3,322)	10,696
Reverse repos	38,882	(7,292)	31,590	–	(31,590)	–
	52,900	(7,292)	45,608	–	(34,912)	10,696
Derivative financial instruments	71,187	(47,035)	24,152	(5,148)	(11,942)	7,062
Loans and advances to banks:						
Excluding reverse repos	4,180	–	4,180	(2,293)	–	1,887
Reverse repos	94	–	94	–	(94)	–
	4,274	–	4,274	(2,293)	(94)	1,887
Loans and advances to customers:						
Excluding reverse repos	450,439	(1,716)	448,723	(1,656)	(7,012)	440,055
Reverse repos	16,832	–	16,832	–	(16,832)	–
	467,271	(1,716)	465,555	(1,656)	(23,844)	440,055
Debt securities	3,637	–	3,637	–	–	3,637
Available-for-sale financial assets	41,717	–	41,717	–	(16,751)	24,966
Financial liabilities						
Deposits from banks:						
Excluding repos	5,713	–	5,713	(3,943)	–	1,770
Repos	23,175	–	23,175	–	(23,175)	–
	28,888	–	28,888	(3,943)	(23,175)	1,770
Customer deposits:						
Excluding repos	417,009	(1,523)	415,486	(1,205)	(7,012)	407,269
Repos	2,638	–	2,638	–	(2,638)	–
	419,647	(1,523)	418,124	(1,205)	(9,650)	407,269
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	9,496	–	9,496	–	–	9,496
Repos	48,670	(7,292)	41,378	–	(41,378)	–
	58,166	(7,292)	50,874	–	(41,378)	9,496
Derivative financial instruments	71,927	(47,228)	24,699	(3,949)	(15,594)	5,156

45 Offsetting of financial assets and liabilities (continued)

At 31 December 2016	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-cash collateral received/pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	18,119	–	18,119	–	(3,265)	14,854
Reverse repos	35,298	(2,219)	33,079	–	(33,079)	–
	53,417	(2,219)	51,198	–	(36,344)	14,854
Derivative financial instruments	90,111	(56,252)	33,859	(6,055)	(17,905)	9,899
Loans and advances to banks:						
Excluding reverse repos	5,146	–	5,146	(2,826)	–	2,320
Reverse repos	437	–	437	–	(437)	–
	5,583	–	5,583	(2,826)	(437)	2,320
Loans and advances to customers:						
Excluding reverse repos	444,614	(1,636)	442,978	(1,793)	(6,300)	434,885
Reverse repos	8,304	–	8,304	–	(8,304)	–
	452,918	(1,636)	451,282	(1,793)	(14,604)	434,885
Debt securities	3,397	–	3,397	–	–	3,397
Available-for-sale financial assets	56,524	–	56,524	–	(21,475)	35,049
Financial liabilities						
Deposits from banks:						
Excluding repos	8,411	–	8,411	(4,663)	–	3,748
Repos	7,279	–	7,279	–	(7,279)	–
	15,690	–	15,690	(4,663)	(7,279)	3,748
Customer deposits:						
Excluding repos	415,153	(2,155)	412,998	(1,391)	(6,300)	405,307
Repos	2,462	–	2,462	–	(2,462)	–
	417,615	(2,155)	415,460	(1,391)	(8,762)	405,307
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	12,437	–	12,437	–	–	12,437
Repos	44,286	(2,219)	42,067	–	(42,067)	–
	56,723	(2,219)	54,504	–	(42,067)	12,437
Derivative financial instruments	89,629	(55,733)	33,896	(4,620)	(22,819)	6,457

[1] After impairment allowance.

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

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

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

46 Financial risk management

Financial instruments are fundamental to the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group.

Disclosures in this note exclude the Group's discontinued operations.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and currency risk; liquidity risk and insurance risk. Information about the Group's management of these risks is given below.

(1) Credit risk

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

A. Maximum credit exposure

The maximum credit risk exposure of the Group 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, which includes amounts held to cover unit-linked and With-Profit funds liabilities, is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	At 31 December 2017			At 31 December 2016		
The Group	**Maximum exposure £m**	**Offset[2] £m**	**Net exposure £m**	Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and receivables:						
Loans and advances to banks, net[1]	**4,274**	**–**	**4,274**	5,583	–	5,583
Loans and advances to customers, net[1]	**465,555**	**(7,012)**	**458,543**	451,282	(6,300)	444,982
Debt securities, net[1]	**3,637**	**–**	**3,637**	3,397	–	3,397
	473,466	**(7,012)**	**466,454**	460,262	(6,300)	453,962
Available-for-sale financial assets[3]	**41,717**	**–**	**41,717**	55,311	–	55,311
Trading and other financial assets at fair value through profit or loss[3]:						
Loans and advances	**32,182**	**–**	**32,182**	33,656	–	33,656
Debt securities, treasury and other bills	**13,376**	**–**	**13,376**	16,956	–	16,956
	45,558	**–**	**45,558**	50,612	–	50,612
Derivative assets	**24,152**	**(11,184)**	**12,968**	33,859	(16,538)	17,321
Financial guarantees	**5,820**	**–**	**5,820**	6,883	–	6,883
Off-balance sheet items:						
Acceptances and endorsements	**71**	**–**	**71**	21	–	21
Other items serving as direct credit substitutes	**740**	**–**	**740**	779	–	779
Performance bonds and other transaction-related contingencies	**2,300**	**–**	**2,300**	2,237	–	2,237
Irrevocable commitments	**60,126**	**–**	**60,126**	63,203	–	63,203
	63,237	**–**	**63,237**	66,240	–	66,240
	653,950	**(18,196)**	**635,754**	673,167	(22,838)	650,329

46 Financial risk management (continued)

The Bank	At 31 December 2017 Maximum exposure £m	Offset[2] £m	Net exposure £m	At 31 December 2016 Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and receivables:						
Loans and advances to banks, net[1]	3,611	–	3,611	4,379	–	4,379
Loans and advances to customers, net[1]	170,804	(2,528)	168,276	161,161	(2,262)	158,899
Debt securities, net[1]	3,182	–	3,182	2,818	–	2,818
	177,597	(2,528)	175,069	168,358	(2,262)	166,096
Available-for-sale financial assets[3]	42,566	–	42,566	54,391	–	54,391
Trading and other financial assets at fair value through profit or loss[3]						
Loans and advances	32,182	–	32,182	34,599	–	34,599
Debt securities, treasury and other bills	11,795	–	11,795	13,710	–	13,710
	43,977	–	43,977	48,309	–	48,309
Derivative assets	26,764	(9,476)	17,288	36,714	(14,700)	22,014
Financial guarantees	5,580	–	5,580	6,586	–	6,586
Off-balance sheet items:						
Acceptances and endorsements	70	–	70	20	–	20
Other items serving as direct credit substitutes	722	–	722	760	–	760
Performance bonds and other transaction-related contingencies	2,167	–	2,167	2,091	–	2,091
Irrevocable commitments	42,010	–	42,010	45,976	–	45,976
	44,969	–	44,969	48,847	–	48,847
	341,453	(12,004)	329,449	363,205	(16,962)	346,243

[1] Amounts shown net of related impairment allowances.

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

[3] Excluding equity shares.

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.

At 31 December 2017 the most significant concentrations of exposure were in mortgages (comprising 65 per cent of total loans and advances to customers) and to financial, business and other services (comprising 12 per cent of the total). For further information on concentrations of the Group's loans, refer to note 15.

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

46 Financial risk management (continued)

C. Credit quality of assets

Loans and receivables

The disclosures in the table below are produced under the underlying basis used for the Lloyds Banking Group's segmental reporting. The Group believes that, for reporting periods immediately following a significant acquisition, this underlying basis, which includes the allowance for loan losses at the acquisition date on a gross basis, more fairly reflects the underlying provisioning status of the loans. The remaining acquisition-related fair value adjustments in respect of this lending are therefore identified separately in this table.

The analysis of lending between retail and commercial has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within commercial are exposures to corporate customers and other large institutions.

Loans and advances – The Group

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
31 December 2017						
Neither past due nor impaired	**4,240**	**295,583**	**48,897**	**109,698**	**454,178**	**32,182**
Past due but not impaired	**6**	**5,934**	**585**	**336**	**6,855**	**–**
Impaired – no provision required	**28**	**640**	**306**	**640**	**1,586**	**–**
– provision held	**–**	**3,525**	**1,053**	**1,608**	**6,186**	**–**
Gross	**4,274**	**305,682**	**50,841**	**112,282**	**468,805**	**32,182**
Allowance for impairment losses	**–**	**(1,604)**	**(655)**	**(1,177)**	**(3,436)**	**–**
Fair value adjustments	**–**				**186**	**–**
Net balance sheet carrying value	**4,274**				**465,555**	**32,182**

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
31 December 2016						
Neither past due nor impaired	5,577	296,105	39,478	102,886	438,469	33,656
Past due but not impaired	6	7,340	386	305	8,031	–
Impaired – no provision required	–	784	392	689	1,865	–
– provision held	–	3,536	1,038	2,056	6,630	–
Gross	5,583	307,765	41,294	105,936	454,995	33,656
Allowance for impairment losses	–	(1,696)	(458)	(1,378)	(3,532)	–
Fair value adjustments	–				(181)	–
Net balance sheet carrying value	5,583				451,282	33,656

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(h). Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £2,400 million (2016: £2,870 million).

46 Financial risk management (continued)

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

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2017						
Good quality	**4,014**	**294,566**	**43,145**	**74,423**		**32,140**
Satisfactory quality	**198**	**790**	**4,770**	**30,154**		**42**
Lower quality	**28**	**32**	**286**	**4,807**		**–**
Below standard, but not impaired	**–**	**195**	**696**	**314**		**–**
Total loans and advances which are neither past due nor impaired	**4,240**	**295,583**	**48,897**	**109,698**	**454,178**	**32,182**
31 December 2016						
Good quality	5,434	295,088	34,195	65,605		33,626
Satisfactory quality	87	814	4,479	30,433		30
Lower quality	3	39	387	6,433		–
Below standard, but not impaired	53	164	417	415		–
Total loans and advances which are neither past due nor impaired	5,577	296,105	39,478	102,886	438,469	33,656

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

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

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2017						
0-30 days	**6**	**3,057**	**458**	**246**	**3,761**	**–**
30-60 days	**–**	**1,115**	**111**	**10**	**1,236**	**–**
60-90 days	**–**	**785**	**3**	**13**	**801**	**–**
90-180 days	**–**	**977**	**3**	**8**	**988**	**–**
Over 180 days	**–**	**–**	**10**	**59**	**69**	**–**
Total loans and advances which are past due but not impaired	**6**	**5,934**	**585**	**336**	**6,855**	**–**
31 December 2016						
0-30 days	6	3,547	285	157	3,989	–
30-60 days	–	1,573	75	37	1,685	–
60-90 days	–	985	2	74	1,061	–
90-180 days	–	1,235	6	14	1,255	–
Over 180 days	–	–	18	23	41	–
Total loans and advances which are past due but not impaired	6	7,340	386	305	8,031	–

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

46 Financial risk management (continued)

Loans and advances – The Bank

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss[1] £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
31 December 2017						
Neither past due nor impaired	**3,583**	**56,592**	**24,453**	**87,150**	**168,195**	**32,182**
Past due but not impaired	**–**	**762**	**282**	**170**	**1,214**	**–**
Impaired – no provision required	**28**	**374**	**157**	**532**	**1,063**	**–**
– provision held	**–**	**161**	**657**	**625**	**1,443**	**–**
Gross	**3,611**	**57,889**	**25,549**	**88,477**	**171,915**	**32,182**
Allowance for impairment losses (note 18)	**–**	**(96)**	**(298)**	**(717)**	**(1,111)**	**–**
Net balance sheet carrying value	**3,611**	**57,793**	**25,251**	**87,760**	**170,804**	**32,182**

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss[1] £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
31 December 2016						
Neither past due nor impaired	4,378	53,950	26,841	77,503	158,294	34,599
Past due but not impaired	1	953	227	168	1,348	–
Impaired – no provision required	–	385	209	576	1,170	–
– provision held	–	201	714	470	1,385	–
Gross	4,379	55,489	27,991	78,717	162,197	34,599
Allowance for impairment losses (note 18)	–	(112)	(258)	(666)	(1,036)	–
Net balance sheet carrying value	4,379	55,377	27,733	78,051	161,161	34,599

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

Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £1,259 million (2016: £1,134 million).

46 Financial risk management (continued)

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

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2017						
Good quality	**3,385**	**56,578**	**21,466**	**59,687**		**32,140**
Satisfactory quality	**198**	**14**	**2,584**	**23,744**		**42**
Lower quality	**–**	**–**	**146**	**3,525**		**–**
Below standard, but not impaired	**–**	**–**	**257**	**194**		**–**
Total loans and advances which are neither past due nor impaired	**3,583**	**56,592**	**24,453**	**87,150**	**168,195**	**32,182**
31 December 2016						
Good quality	4,307	53,934	23,444	49,503		34,569
Satisfactory quality	29	16	2,851	23,739		30
Lower quality	–	–	227	4,012		–
Below standard, but not impaired	42	–	319	249		–
Total loans and advances which are neither past due nor impaired	4,378	53,950	26,841	77,503	158,294	34,599

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

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2017						–
0-30 days	**–**	**362**	**218**	**159**	**739**	**–**
30-60 days	**–**	**153**	**62**	**5**	**220**	**–**
60-90 days	**–**	**112**	**1**	**3**	**116**	**–**
90-180 days	**–**	**135**	**1**	**2**	**138**	**–**
Over 180 days	**–**	**–**	**–**	**1**	**1**	**–**
Total loans and advances which are past due but not impaired	**–**	**762**	**282**	**170**	**1,214**	**–**
31 December 2016						
0-30 days	1	461	181	98	740	–
30-60 days	–	201	37	19	257	–
60-90 days	–	124	–	43	167	–
90-180 days	–	167	2	4	173	–
Over 180 days	–	–	7	4	11	–
Total loans and advances which are past due but not impaired	1	953	227	168	1,348	–

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

46 Financial risk management (continued)

Debt securities classified as loans and receivables

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

	2017			2016		
The Group	**Investment grade[1] £m**	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Asset-backed securities:						
Mortgage-backed securities	**2,366**	**–**	**2,366**	2,089	–	2,089
Other asset-backed securities	**1,164**	**96**	**1,260**	1,192	98	1,290
	3,530	**96**	**3,626**	3,281	98	3,379
Corporate and other debt securities	**–**	**14**	**14**	29	65	94
Gross exposure	**3,530**	**110**	**3,640**	3,310	163	3,473
Allowance for impairment losses			**(3)**			(76)
Total debt securities classified as loans and receivables			**3,637**			3,397
The Bank						
Asset-backed securities:						
Mortgage-backed securities	**2,263**	**–**	**2,263**	1,914	–	1,914
Other asset-backed securities	**919**	**–**	**919**	904	–	904
	3,182	**–**	**3,182**	2,818	–	2,818
Corporate and other debt securities	**–**	**–**	**–**	–	–	–
Gross exposure	**3,182**	**–**	**3,182**	2,818	–	2,818
Allowance for impairment losses			**–**			–
Total debt securities classified as loans and receivables			**3,182**			2,818

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

[2] Other comprises sub-investment grade (2017: £96 million for the Group and £nil for the Bank; 2016: £91 million for the Group and £nil for the Bank) and not rated (2017: £14 million for the Group and £nil for the Bank; 2016: £72 million for the Group and £nil for the Bank.)

Available-for-sale financial assets (excluding equity shares)

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

	2017			2016		
The Group	**Investment grade[1] £m**	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities						
Government securities	**34,708**	**–**	**34,708**	48,714	–	48,714
Bank and building society certificates of deposit	**167**	**–**	**167**	142	–	142
Asset-backed securities:						
Mortgage-backed securities	**1,156**	**–**	**1,156**	108	–	108
Other asset-backed securities	**235**	**20**	**255**	312	5	317
	1,391	**20**	**1,411**	420	5	425
Corporate and other debt securities	**4,250**	**365**	**4,615**	6,030	–	6,030
Total held as available-for-sale financial assets	**40,516**	**385**	**40,901**	55,306	5	55,311

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

[2] Other comprises sub-investment grade (2017: £9 million; 2016: £5 million) and not rated (2017: £376 million; 2016: £nil.)

46 Financial risk management (continued)

The Bank	2017 Investment grade[1] £m	2017 Other[2] £m	2017 Total £m	2016 Investment grade[1] £m	2016 Other[2] £m	2016 Total £m
Debt securities						
Government securities	**34,571**	**–**	**34,571**	48,576	–	48,576
Bank and building society certificates of deposit	**167**	**–**	**167**	142	–	142
Asset-backed securities:						
Mortgage-backed securities	**1,129**	**–**	**1,129**	71	–	71
Other asset-backed securities	**64**	**1**	**65**	123	4	127
	1,193	**1**	**1,194**	194	4	198
Corporate and other debt securities	**3,514**	**306**	**3,820**	3,603	–	3,603
	39,445	**307**	**39,752**	52,515	4	52,519
Due from fellow Group undertakings:						
Corporate and other debt securities			**2,051**			1,872
Total held as available-for-sale financial assets			**41,803**			54,391

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

[2] Other comprises sub-investment grade (2017: £nil; 2016: £4 million) and not rated (2017: £307 million; 2016: £nil.)

Debt securities, treasury and other bills held at fair value through profit or loss

An analysis of trading and other financial assets at fair value through profit or loss is included in note 13. The credit quality of debt securities, treasury and other bills held at fair value through profit or loss is set out below.

The Group	2017 Investment grade[1] £m	2017 Other[2] £m	2017 Total £m	2016 Investment grade[1] £m	2016 Other[2] £m	2016 Total £m
Trading assets						
Government securities	**9,836**	**–**	**9,836**	11,828	–	11,828
Asset-backed securities:						
Mortgage-backed securities	**84**	**105**	**189**	47	–	47
Other asset-backed securities	**95**	**–**	**95**	69	–	69
	179	**105**	**284**	116	–	116
Corporate and other debt securities	**468**	**54**	**522**	221	3	224
Total held as trading assets	**10,483**	**159**	**10,642**	12,165	3	12,168
Other assets held at fair value through profit or loss						
Government securities	**928**	**–**	**928**	1,127	–	1,127
Other public sector securities	**–**	**–**	**–**	–	–	–
Bank and building society certificates of deposit	**222**	**–**	**222**	244	–	244
Asset-backed securities:						
Mortgage-backed securities	**–**	**–**	**–**	–	–	–
Other asset-backed securities	**–**	**–**	**–**	–	–	–
	–	**–**	**–**	–	–	–
Corporate and other debt securities	**–**	**210**	**210**	1,730	1,667	3,397
Total debt securities held at fair value through profit or loss	**1,150**	**210**	**1,360**	3,101	1,667	4,768
Treasury bills and other bills	**18**	**–**	**18**	20	–	20
Total other assets held at fair value through profit or loss	**1,168**	**210**	**1,378**	3,121	1,667	4,788
	11,651	**369**	**12,020**	15,286	1,670	16,956
Due from fellow Group undertakings:						
Corporate and other debt securities			**1,356**			–
Total held at fair value through profit or loss			**13,376**			16,956

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

[2] Other comprises sub-investment grade (2017: £nil; 2016: £3 million) and not rated (2017: £369 million; 2016: £1,667 million.)

46 Financial risk management (continued)

Credit risk in respect of trading and other financial assets at fair value through profit or loss here within the Group's unit-linked funds is borne by the policyholders and credit risk in respect of with-profits funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back those contract liabilities.

The Bank	2017 Investment grade[1] £m	2017 Other[2] £m	2017 Total £m	2017 Investment grade[1] £m	2017 Other[2] £m	2017 Total £m
Trading assets						
Government securities	**9,834**	**–**	**9,834**	11,828	–	11,828
Asset-backed securities:						
Mortgage-backed securities	**84**	**105**	**189**	47	–	47
Other asset-backed securities	**95**	**–**	**95**	69	–	69
	179	**105**	**284**	116	–	116
Corporate and other debt securities	**468**	**54**	**522**	221	3	224
Total debt securities	**10,481**	**159**	**10,640**	12,165	3	12,168
Treasury bills and other bills	**–**	**–**	**–**	–	–	–
Total held as trading assets	**10,481**	**159**	**10,640**	12,165	3	12,168
Other assets held at fair value through profit or loss						
Government securities	**928**	**–**	**928**	1,127	–	1,127
Corporate and other debt securities	**–**	**210**	**210**	395	–	395
Total other assets held at fair value through profit or loss	**928**	**210**	**1,138**	1,522	–	1,522
	11,409	**369**	**11,778**	13,687	3	13,690
Due from fellow Group undertakings:						
Corporate and other debt securities			**17**			20
Total held at fair value through profit or loss			**11,795**			13,710

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

[2] Other comprises sub-investment grade (2017: £nil; 2016: £3 million) and not rated (2017: £369 million; 2016: £nil.)

Derivative assets

An analysis of derivative assets is given in note 14. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net credit risk relating to derivative assets of £12,968 million for the Group and £17,288 million for the Bank (2016: £17,321 million for the Group and £22,014 million for the Bank), cash collateral of £5,148 million for the Group and £3,909 million for the Bank (2016: £6,055 million for the Group and £4,841 million for the Bank) was held and a further £275 million for the Group and £196 million for the Bank (2016: £613 million for the Group and £451 million for the Bank) was due from OECD banks.

The Group	2017 Investment grade[1] £m	2017 Other[2] £m	2017 Total £m	2016 Investment grade[1] £m	2016 Other[2] £m	2016 Total £m
Trading and other	**20,285**	**1,967**	**22,252**	29,361	1,786	31,147
Hedging	**1,894**	**6**	**1,900**	2,664	48	2,712
Total derivative financial instruments	**22,179**	**1,973**	**24,152**	32,025	1,834	33,859
The Bank						
Trading and other	**17,403**	**714**	**18,117**	24,626	955	25,581
Hedging	**467**	**2**	**469**	1,413	13	1,426
	17,870	**716**	**18,586**	26,039	968	27,007
Due from fellow Group undertakings			**8,178**			9,707
Total derivative financial instruments			**26,764**			36,714

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

[2] Other comprises sub-investment grade (2017: £1,878 million for the Group and £623 million for the Bank; 2016: £1,830 million for the Group and £968 million for the Bank) and not rated (2017: £95 million for the Group and £93 million for the Bank; 2016: £4 million for the Group and £nil for the Bank.)

46 Financial risk management (continued)

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

D. Collateral held as security for financial assets
The Group holds collateral against loans and receivables and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for trading and other financial assets at fair value through profit or loss and for derivative assets is also shown below.

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

Loans and advances to banks
There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £94 million for the Group and the Bank (2016: £437 million for the Group and the Bank), against which the Group and the Bank held collateral with a fair value of £95 million (2016: £371 million for the Group and the Bank).

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

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

	2017				2016			
The Group	**Neither past due nor impaired £m**	**Past due but not impaired £m**	**Impaired £m**	**Gross £m**	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70 per cent	**216,888**	**4,309**	**2,444**	**223,641**	220,299	5,288	2,334	227,921
70 per cent to 80 per cent	**43,045**	**787**	**592**	**44,424**	39,789	1,004	648	41,441
80 per cent to 90 per cent	**25,497**	**500**	**435**	**26,432**	23,589	621	495	24,705
90 per cent to 100 per cent	**7,085**	**177**	**244**	**7,506**	7,983	223	355	8,561
Greater than 100 per cent	**3,068**	**161**	**450**	**3,679**	4,445	204	488	5,137
Total	**295,583**	**5,934**	**4,165**	**305,682**	296,105	7,340	4,320	307,765

	2017				2017			
The Bank	**Neither past due nor impaired £m**	**Past due but not impaired £m**	**Impaired £m**	**Gross £m**	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70 per cent	**47,274**	**578**	**351**	**48,203**	44,677	793	344	45,814
70 per cent to 80 per cent	**5,640**	**99**	**73**	**5,812**	5,210	90	88	5,388
80 per cent to 90 per cent	**2,783**	**56**	**47**	**2,886**	2,866	50	63	2,979
90 per cent to 100 per cent	**663**	**19**	**38**	**720**	925	16	51	992
Greater than 100 per cent	**232**	**10**	**26**	**268**	272	4	40	316
Total	**56,592**	**762**	**535**	**57,889**	53,950	953	586	55,489

Other
The majority of non-mortgage retail lending is unsecured. At 31 December 2017, impaired non-mortgage lending amounted to £817 million, net of an impairment allowance of £542 million (2016: £972 million, net of an impairment allowance of £458 million). The fair value of the collateral held in respect of this lending was £154 million (2016: £139 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation and the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Unimpaired non-mortgage retail lending amounted to £49,482 million (2016: £39,864 million). Lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination and are thereafter monitored in accordance with business unit credit policy.

The Group credit risk disclosures for unimpaired non-mortgage retail lending report assets gross of collateral and therefore disclose the maximum loss exposure. The Group believes that this approach is appropriate. The value of collateral is reassessed if there is observable evidence of distress of the borrower. Unimpaired

46 Financial risk management (continued)

non-mortgage retail lending, including any associated collateral, is managed on a customer-by-customer basis rather than a portfolio basis. No aggregated collateral information for the entire unimpaired non-mortgage retail lending portfolio is provided to key management personnel.

Commercial lending

Reverse repurchase transactions

At 31 December 2017 there were reverse repurchase agreements which were accounted for as collateralised loans with a carrying value of £16,832 million for the Group and the Bank (2016: £8,304 million for the Group and the Bank) against which the Group and the Bank held collateral with a fair value of £17,122 million (2016: £7,490 million for the Group and the Bank) all of which the Group was able to repledge. Included in these amounts were collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £nil for the Group and the Bank (2016: £8 million for the Group and the Bank). These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Impaired secured lending

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

At 31 December 2017, impaired secured commercial lending amounted to £644 million, net of an impairment allowance of £236 million (2016: £204 million, net of an impairment allowance of £401 million). The fair value of the collateral held in respect of impaired secured commercial lending was £797 million (2016: £1,160 million) for the Group. In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured commercial lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

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

Unimpaired secured lending

Unimpaired secured commercial lending amounted to £41,484 million (2016: £36,275 million).

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

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

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

Included in trading and other financial assets at fair value through profit or loss are reverse repurchase agreements treated as collateralised loans with a carrying value of £31,590 million for the Group and the Bank (2016: £33,079 million for the Group and the Bank). Collateral is held with a fair value of £39,099 million for the Group and the Bank (2016: £30,850 million for the Group and the Bank), all of which the Group is able to repledge. At 31 December 2017, £31,281 million for the Group and the Bank had been repledged (2016: £27,303 million for the Group and the Bank).

In addition, securities held as collateral in the form of stock borrowed amounted to £61,469 million for the Group and £17,504 million for the Bank 2016: £47,816 million for the Group and £25,565 million for the Bank). Of this amount, £44,432 million for the Group and £471 million for the Bank (2016: £16,204 million for the Group and £18,025 million for 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 £12,968 million for the Group and £17,288 million for the Bank (2016: £17,321 million for the Group and £22,014 million for the Bank), cash collateral of £5,148 million for the Group and £3,909 million for the Bank 2016: £6,055 million for the Group and £4,841 million for the Bank) was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2017, there were irrevocable loan commitments and other credit-related contingencies of £63,237 million for the Group and £44,969 million for the Bank (2016: £66,240 million for the Group and £48,847 million for the Bank). Collateral is held as security, in the event that lending is drawn down, on £10,314 million for the Group and £20 million for the Bank (2016: £10,053 million for the Group and £9 million for the Bank) of these balances.

Collateral repossessed

During the year, £297 million of collateral was repossessed (2016: £241 million), consisting primarily of residential property. In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against commercial lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

E. Collateral pledged as security

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

Repurchase transactions

Deposits from banks

Included in deposits from banks are balances arising from repurchase transactions of £23,175 million for the Group and £3,198 million for the Bank (2016: £7,279 million for the Group and £2,758 million for the Bank); the fair value of the collateral provided under these agreements at 31 December 2017 was £23,082 million for the Group and £3,156 million for the Bank (2016: £8,395 million for the Group and £2,692 million for the Bank).

46 Financial risk management (continued)

Customer deposits
Included in customer deposits are balances arising from repurchase transactions of £2,638 million for the Group and £2,637 million for the Bank (2016: £2,462 million for the Group and the Bank); the fair value of the collateral provided under these agreements at 31 December 2017 was £2,640 million for the Group and the Bank (2016: £nil for the Group and the Bank).

Trading and other financial liabilities at fair value through profit or loss
The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowing, where the secured party is permitted by contract or custom to repledge was £48,765 million for the Group and the Bank (2016: £45,702 million for the Group and £46,698 million for the Bank).

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Trading and other financial assets at fair value through profit or loss	**1,320**	1,541	**1,314**	1,523
Loans and advances to customers	**197**	583	**197**	583
Available-for-sale financial assets	**2,608**	3,206	**2,469**	3,184
	4,125	5,330	**3,980**	5,290

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

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

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However, a significant proportion of the Group's lending assets, for example many personal loans and mortgages, bear interest rates which are contractually fixed.

The Group and the Bank establish two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group and the Bank are exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt.

At 31 December 2017 the aggregate notional principal of interest rate swaps designated as fair value hedges was £114,045 million (2016: £195,889 million) for the Group and £120,076 million (2016: £204,068 million) for the Bank with a net fair value asset of £507 million (2016: asset of £435 million) for the Group and a net fair value liability of £1,296 million (2016: liability of £1,757 million) for the Bank (note 14). There were losses recognised on the hedging instruments of £450 million (2016: £1,946 million) for the Group and gains of £335 million (2016: losses of £1,768 million) for the Bank. There were gains on the hedged items attributable to the hedged risk of £514 million (2016: £2,017 million) for the Group and losses of £308 million (2016: £1,702 million) for the Bank.

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. Note 14 shows when the hedged cash flows are expected to occur and when they will affect income for the designated cash flow hedges. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2017 was £549,099 million (2016: £384,182 million) for the Group and £127,228 million (2016: £381,662 million) for the Bank with a net fair value liability of £458 million (2016: liability of £352 million) for the Group and a net fair value asset of £10 million (2016: asset of £75 million) for the Bank (note 14). In 2017, ineffectiveness recognised in the income statement that arises from cash flow hedges was gains of £21 million (2016: gains of £24 million) for the Group and £66 million (2016: gains of £28 million) for the Bank.

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

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

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using currency borrowings. The Bank does not hedge its exposure. At 31 December 2017 the aggregate principal of the Group's currency borrowings was £41 million (2016: £695 million). In 2017, an ineffectiveness loss of £11 million before and £8 million after tax (2016: ineffectiveness loss of £2 million before and £1 million after tax) was recognised in the income statement arising from net investment hedges.

46 Financial risk management (continued)

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

Functional currency of Group operations

The Group	Euro £m	US Dollar £m	Other non-sterling £m
31 December 2017			
Gross exposure	**73**	**374**	**32**
Net investment hedges	**(41)**	**–**	**–**
Total structural foreign currency exposures, after net investment hedges	**32**	**374**	**32**
31 December 2016			
Gross exposure	247	479	36
Net investment hedges	(216)	(479)	–
Total structural foreign currency exposures, after net investment hedges	31	–	36

The Bank	Euro £m	US Dollar £m	Other non-sterling £m
31 December 2017			
Gross exposure	**6**	**53**	**–**
Net investment hedges	–	–	–
Total structural foreign currency exposures, after net investment hedges	**6**	**53**	**–**
31 December 2016			
Gross exposure	6	72	45
Net investment hedges	–	–	–
Total structural foreign currency exposures, after net investment hedges	6	72	45

(3) Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The tables below analyse financial instrument liabilities of the Group and the Bank, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category. Certain balances, included in the table below on the basis of their residual maturity, are repayable on demand upon payment of a penalty.

The Group	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2017						
Deposits from banks	**1,873**	**3,544**	**2,096**	**21,498**	**387**	**29,398**
Customer deposits	**367,104**	**18,854**	**21,308**	**11,170**	**2,375**	**420,811**
Trading and other financial liabilities at fair value through profit or loss	**21,286**	**14,424**	**6,499**	**4,251**	**13,041**	**59,501**
Debt securities in issue	**3,407**	**6,341**	**12,378**	**31,642**	**16,833**	**70,601**
Subordinated liabilities	**265**	**490**	**3,095**	**7,131**	**10,965**	**21,946**
Total non-derivative financial liabilities	**393,935**	**43,653**	**45,376**	**75,692**	**43,601**	**602,257**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**23,850**	**31,974**	**24,923**	**43,425**	**30,473**	**154,645**
Gross settled derivatives – inflows	**(23,028)**	**(30,972)**	**(23,886)**	**(43,506)**	**(31,932)**	**(153,324)**
Gross settled derivatives – net flows	**822**	**1,002**	**1,037**	**(81)**	**(1,459)**	**1,321**
Net settled derivative liabilities	**17,414**	**9**	**142**	**452**	**992**	**19,009**
Total derivative financial liabilities	**18,236**	**1,011**	**1,179**	**371**	**(467)**	**20,330**

46 Financial risk management (continued)

The Group	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2016						
Deposits from banks	3,232	4,154	1,541	5,883	942	15,752
Customer deposits	347,537	19,147	28,248	20,789	1,283	417,004
Trading and other financial liabilities at fair value through profit or loss	14,390	19,718	11,845	1,938	13,513	61,404
Debt securities in issue	7,661	8,808	12,628	34,928	16,987	81,012
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–
Subordinated liabilities	48	755	1,201	9,678	10,944	22,626
Total non-derivative financial liabilities	372,868	52,582	55,463	73,216	43,669	597,798
Derivative financial liabilities:						
Gross settled derivatives – outflows	33,126	24,044	25,336	52,769	35,214	170,489
Gross settled derivatives – inflows	(31,358)	(22,395)	(23,485)	(49,111)	(31,149)	(157,498)
Gross settled derivatives – net flows	1,768	1,649	1,851	3,658	4,065	12,991
Net settled derivative liabilities	21,615	44	170	536	1,127	23,492
Total derivative financial liabilities	23,383	1,693	2,021	4,194	5,192	36,483

The Group's financial guarantee contracts are accounted for as financial instruments and measured at fair value, upon initial recognition, on the balance sheet. The majority of the Group's financial guarantee contracts are callable on demand, were the guaranteed party to fail to meet its obligations. It is, however, expected that most guarantees will expire unused. The contractual nominal amounts of these guarantees totalled £5,820 million at 31 December 2017 (2016: £6,883 million) with £3,132 million expiring within one year; £627 million between one and three years; £1,471 million between three and five years; and £590 million over five years (2016: £3,815 million expiring within one year; £667 million between one and three years; £1,334 million between three and five years; and £1,067 million over five years).

The majority of the Group's non-participating investment contract liabilities are unit-linked. These unit-linked products are invested in accordance with unit fund mandates. Clauses are included in policyholder contracts to permit the deferral of sales, where necessary, so that linked assets can be realised without being a forced seller.

Liabilities of the Group arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	**1-2 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
At 31 December 2017	**1,708**	**1,747**	**6,467**	**26,479**	**67,033**	**103,434**
At 31 December 2016	1,283	1,836	6,266	23,425	61,599	94,409

For insurance and participating investment contracts which are neither unit-linked nor in the Group's with-profit funds, in particular annuity liabilities, the aim is to invest in assets such that the cash flows on investments match those on the projected future liabilities.

46 Financial risk management (continued)

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £23 million (2016: £22 million) per annum for the Group and £17 million (2016: £15 million) for the Bank which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

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 2017						
Deposits from banks	**1,685**	**2,319**	**2,002**	**1,243**	**383**	**7,632**
Customer deposits	**211,268**	**13,766**	**8,494**	**1,140**	**1,654**	**236,322**
Trading and other financial liabilities at fair value through profit or loss	**21,365**	**14,478**	**6,523**	**4,217**	**13,089**	**59,672**
Debt securities in issue	**8,687**	**4,370**	**14,422**	**28,192**	**17,827**	**73,498**
Subordinated liabilities	**266**	**258**	**462**	**5,522**	**6,512**	**13,020**
Total non-derivative financial liabilities	**243,271**	**35,191**	**31,903**	**40,314**	**39,465**	**390,144**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**23,756**	**31,750**	**24,690**	**40,258**	**26,933**	**147,387**
Gross settled derivatives – inflows	**(22,985)**	**(30,784)**	**(23,655)**	**(40,222)**	**(28,244)**	**(145,890)**
Gross settled derivatives – net flows	**771**	**966**	**1,035**	**36**	**(1,311)**	**1,497**
Net settled derivative liabilities	**15,430**	**(4)**	**101**	**288**	**812**	**16,627**
Total derivative financial liabilities	**16,201**	**962**	**1,136**	**324**	**(499)**	**18,124**

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 2016						
Deposits from banks	3,159	4,118	1,532	84	617	9,510
Customer deposits	187,112	13,960	8,355	3,551	429	213,407
Trading and other financial liabilities at fair value through profit or loss	14,688	20,127	12,091	1,979	13,791	62,676
Debt securities in issue	6,730	7,510	12,551	32,047	21,450	80,288
Subordinated liabilities	58	304	554	5,989	6,588	13,493
Total non-derivative financial liabilities	211,747	46,019	35,083	43,650	42,875	379,374
Derivative financial liabilities:						
Gross settled derivatives – outflows	32,460	23,495	24,793	47,970	30,802	159,520
Gross settled derivatives – inflows	(30,886)	(21,902)	(22,965)	(44,512)	(27,067)	(147,332)
Gross settled derivatives – net flows	1,574	1,593	1,828	3,458	3,735	12,188
Net settled derivative liabilities	19,104	28	84	325	883	20,424
Total derivative financial liabilities	20,678	1,621	1,912	3,783	4,618	32,612

The Bank's financial guarantee contracts are accounted for as financial instruments and measured at fair value, upon initial recognition, on the balance sheet. The majority of the Bank's financial guarantee contracts are callable on demand, were the guaranteed party to fail to meet its obligations. It is, however, expected that most guarantees will expire unused. The contractual nominal amounts of these guarantees totalled £5,580 million at 31 December 2017 (2016: £6,586 million) with £2,995 million expiring within one year; £584 million between one and three years; £1,446 million between three and five years; and £555 million over five years (2016: £3,690 million expiring within one year; £627 million between one and three years; £1,322 million between three and five years; and £947 million over five years).

46 Financial risk management (continued)

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

The Group	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2017					
Acceptances and endorsements	**67**	**4**	**–**	**–**	**71**
Other contingent liabilities	**1,607**	**506**	**271**	**656**	**3,040**
Total contingent liabilities	**1,674**	**510**	**271**	**656**	**3,111**
Lending commitments	**92,996**	**17,320**	**15,106**	**3,913**	**129,335**
Other commitments	**57**	**46**	**71**	**210**	**384**
Total commitments	**93,053**	**17,366**	**15,177**	**4,123**	**129,719**
Total contingents and commitments	**94,727**	**17,876**	**15,448**	**4,779**	**132,830**
31 December 2016					
Acceptances and endorsements	20	1	–	–	21
Other contingent liabilities	1,647	466	280	623	3,016
Total contingent liabilities	1,667	467	280	623	3,037
Lending commitments	73,443	17,212	18,775	4,090	113,520
Other commitments	45	79	122	402	648
Total commitments	73,488	17,291	18,897	4,492	114,168
Total contingents and commitments	75,155	17,758	19,177	5,115	117,205

The Bank	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2017					
Acceptances and endorsements	**66**	**4**	**–**	**–**	**70**
Other contingent liabilities	**1,538**	**505**	**206**	**640**	**2,889**
Total contingent liabilities	**1,604**	**509**	**206**	**640**	**2,959**
Lending commitments	**35,753**	**16,092**	**14,506**	**2,707**	**69,058**
Other commitments	**57**	**46**	**71**	**179**	**353**
Total commitments	**35,810**	**16,138**	**14,577**	**2,886**	**69,411**
Total contingents and commitments	**37,414**	**16,647**	**14,783**	**3,526**	**72,370**
31 December 2016					
Acceptances and endorsements	19	1	–	–	20
Other contingent liabilities	1,587	449	217	598	2,851
Total contingent liabilities	1,606	450	217	598	2,871
Lending commitments	38,668	15,768	18,076	2,534	75,046
Other commitments	45	73	112	390	620
Total commitments	38,713	15,841	18,188	2,924	75,666
Total contingents and commitments	40,319	16,291	18,405	3,522	78,537

(4) Insurance risk

Insurance risk is the risk of reductions in earnings capital and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

The Group's appetite for solvency and earnings in insurance entities is reviewed and approved annually by the Board. Insurance risks are measured using a variety of techniques including stress and scenario testing; and where appropriate, stochastic modelling. Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations, as well as evaluating the effectiveness of controls put in place to manage insurance risk.

47 Capital

Capital management
Within the Group, capital within each regulated entity is actively managed at an appropriate level of frequency. Regulatory ratios are a key factor in budgeting and planning processes with updates of expected ratios reviewed regularly by the Lloyds Banking Group Asset and Liability Committee. Capital raised takes account of evolving regulatory requirements, expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight.

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

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

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

A range of additional bank specific regulatory capital buffers apply under CRD IV. These include a capital conservation buffer of 1.25 per cent of risk-weighted assets (increasing to 2.5 per cent by 2019) and a time-varying countercyclical capital buffer for which the Group currently has a negligible requirement based on its minimal exposures to those jurisdictions that have set countercyclical buffer rates. Other capital buffers do not currently apply to the Group as they are either not applicable or are applied at the discretion of the regulator.

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

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

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

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

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

	2017 £m	2016 £m
Common equity tier 1 capital	**32,500**	32,544
Additional tier 1 capital	**5,220**	5,732
Tier 2 capital	**6,579**	7,535
Total capital	**44,299**	45,811

48 Cash flow statements

a Change in operating assets

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Change in loans and receivables	**(25,178)**	1,230	**(2,832)**	(2,917)
Changes in amounts due from fellow Lloyds Banking Group undertakings	**810**	8,412	**(21,810)**	(16,089)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**9,285**	(13,954)	**15,459**	(2,014)
Change in other operating assets	**(650)**	1,012	**69**	69
Change in operating assets	**(15,733)**	(3,300)	**(9,114)**	(20,951)

b Change in operating liabilities

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Change in deposits from banks	**13,415**	(654)	**(1,917)**	(4,261)
Change in customer deposits	**2,935**	(3,690)	**13,417**	6,602
Changes in amounts due to fellow Lloyds Banking Group undertakings	**44**	2,799	**12,812**	16,525
Change in debt securities in issue	**(11,968)**	(8,950)	**(7,852)**	(4,868)
Change in derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	**(12,677)**	11,680	**(15,110)**	6,995
Change in investment contract liabilities	**(4,665)**	(2,665)	**–**	–
Change in other operating liabilities	**(463)**	(549)	**62**	260
Change in operating liabilities	**(13,379)**	(2,029)	**1,412**	21,253

48 Cash flow statements (continued)

c Non-cash and other items

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Depreciation and amortisation	**2,370**	2,380	**932**	821
Permanent diminution in value of investment in subsidiaries	**–**	–	**302**	562
Dividends received from subsidiary undertakings	**–**	–	**(4,479)**	(3,984)
Revaluation of investment properties	**(230)**	83	**–**	–
Allowance for loan losses	**691**	592	**465**	450
Write-off of allowance for loan losses, net of recoveries	**(1,062)**	(1,272)	**(475)**	(608)
Impairment of available-for-sale financial assets	**6**	173	**–**	172
Change in insurance contract liabilities	**9,169**	14,081	**–**	–
Payment protection insurance provision	**1,300**	1,350	**781**	952
Other regulatory provisions	**865**	1,085	**342**	527
Other provision movements	**(17)**	(40)	**(51)**	54
Additional capital injections to subsidiaries	**–**	–	**(149)**	–
Net charge (credit) in respect of defined benefit schemes	**369**	287	**165**	142
Impact of consolidation and deconsolidation of OEICs[1]	**–**	(3,157)	**–**	–
Unwind of discount on impairment allowances	**(23)**	(32)	**(37)**	(44)
Foreign exchange element on balance sheet[2]	**209**	(648)	**718**	272
Interest expense on subordinated liabilities	**1,285**	1,812	**664**	1,175
Loss (profit) on disposal of businesses	**–**	–	**(555)**	–
Other non-cash items	**537**	766	**1,181**	159
Total non-cash items	**15,469**	17,460	**(196)**	650
Contributions to defined benefit schemes	**(587)**	(630)	**(401)**	(425)
Payments in respect of payment protection insurance provision	**(1,657)**	(2,200)	**(946)**	(1,577)
Payments in respect of other regulatory provisions	**(928)**	(761)	**(430)**	(561)
Other	**–**	2	**–**	–
Total other items	**(3,172)**	(3,589)	**(1,777)**	(2,563)
Non-cash and other items	**12,297**	13,871	**(1,973)**	(1,913)

[1] These OEICs (Open-ended investment companies) are mutual funds which are consolidated if the Group manages the funds and also has a sufficient beneficial interest. The population of OEICs to be consolidated varies at each reporting date as external investors acquire and divest holdings in the various funds. The consolidation of these funds is effected by the inclusion of the fund investments and a matching liability to the unit holders; and changes in funds consolidated represent a non-cash movement on the balance sheet.

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

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

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Cash and balances with central banks	**58,521**	47,452	**55,835**	44,595
Less: mandatory reserve deposits[1]	**(957)**	(914)	**(535)**	(455)
	57,564	46,538	**55,300**	44,140
Loans and advances to banks	**4,274**	5,583	**3,611**	4,379
Loans and advances to banks within disposal group (see note 12)	**2,337**	21,319	**–**	–
Less: amounts with a maturity of three months or more	**(3,193)**	(10,532)	**(2,791)**	(3,253)
	3,418	16,370	**820**	1,126
Total cash and cash equivalents	**60,982**	62,908	**56,120**	45,266
Cash and cash equivalents of continuing operations	**58,645**	48,420	**56,120**	45,266
Cash and cash equivalents in disposal group (note 12)	**2,337**	14,488	**–**	–
Total cash and cash equivalents	**60,982**	62,908	**56,120**	45,266

[1] Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents of the Group at 31 December 2017 is £2,322 million (2016: £14,477 million) held within the Group's long-term insurance and investments business, within the disposal group (note 12), which is not immediately available for use in the business.

48 Cash flow statements (continued)

e Acquisition of group undertakings and businesses

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Net assets acquired:				
Cash and cash equivalents	**123**	–	**–**	–
Loans and receivables: Loans and advances to customers	**7,811**	–	**7,311**	–
Available-for-sale financial assets	**16**	–	**–**	–
Intangible assets	**702**	–	**–**	–
Property, plant and equipment	**6**	–	**1**	–
Other assets	**414**	–	**5**	–
Customer deposits	**–**	–	**(8,114)**	–
Deposits from banks[1]	**(6,431)**	–	**–**	–
Net balances with group undertakings	**–**	–	**1,305**	–
Other liabilities	**(927)**	–	**(103)**	–
Goodwill arising on acquisition	**302**	–	**–**	–
Adjustment on vesting of businesses (note 24)	**–**	–	**(278)**	–
Investments in subsidiaries derecognised on vesting of businesses (note 24)	**–**	–	**(127)**	–
Cash consideration	**2,016**	–	**–**	–
Less: Cash and cash equivalents acquired	**(123)**	–	**–**	–
Net cash outflow arising from acquisitions	**1,893**	–	**–**	–
Additional capital injections to subsidiaries	**–**	–	**–**	81
Investment in subsidiary acquired		–	**2,026**	–
Acquisition of and additional investment in joint ventures	**20**	20	**–**	–
Net cash outflow from acquisitions in the year	**1,913**	20	**2,026**	81

[1] Upon acquisition, the funding of MBNA was assumed by the Bank.

f Disposal of group undertakings and businesses

	The Group		The Bank	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Trading and other financial assets at fair value through profit or loss	**2,117**	–	**–**	–
Loans and advances to customers	**344**	–	**–**	–
Due from fellow group undertakings	**176**	–	**–**	–
Available-for-sale financial assets	**375**	–	**–**	–
Property, plant and equipment	**11**	–	**–**	–
	3,023	–	**–**	–
Customer deposits	**(22)**	–	**–**	–
Due to fellow group undertakings	**(1,706)**	–	**–**	–
Non-controlling interests	**(387)**	–	**–**	–
Other net assets (liabilities)	**50**	5	**–**	–
	(2,065)	5	**–**	–
Net assets (liabilities) disposed of	**958**	5	**–**	–
Investment in subsidiary disposed of	**–**	–	**37**	3
Disposal of investment in joint ventures	**26**	–	**–**	–
Profit on sale of businesses	**–**	–	**555**	–
Cash consideration received on losing control of group undertakings and businesses	**984**	5	**592**	3
Cash and cash equivalents disposed	**–**	–	**–**	–
Net cash inflow (outflow)	**984**	5	**592**	3

49 Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2017 and have not been applied in preparing these financial statements. Save as disclosed below, the impact of these accounting changes is still being assessed by the Group and reliable estimates cannot be made at this stage.

With the exception of IFRS 17 'Insurance Contracts', the amendment to IFRS 9 'Prepayment Features with Negative Compensation' and certain other minor amendments as at 20 February 2018 these pronouncements have been endorsed by the EU.

IFRS 9 Financial Instruments
IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for annual periods beginning on or after 1 January 2018. The Group has chosen 1 January 2018 as its initial application date of IFRS 9 and has not restated comparative periods.

Classification and measurement
IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost. Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit or loss. An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch.

In October 2017 the IASB issued an Amendment to IFRS 9, 'Prepayment Features with Negative Compensation' which has an effective date of 1 January 2019. This Amendment changes the requirements of IFRS 9 so that certain prepayment features meet the solely payments of principal and interest test. The Group has some loans in its Commercial Banking division that have these features and so the Group has decided to apply the Amendment in 2018 in order to avoid further changes to accounting for financial assets in 2019. The Amendment is still subject to EU endorsement and the Group assumes this will occur during 2018.

Impairment
The IFRS 9 impairment model will be applicable to all financial assets at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, loan commitments and financial guarantees not measured at fair value through profit or loss.

IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss ('ECL') model resulting in earlier recognition of credit losses compared with IAS 39. Expected credit losses are the unbiased probability weighted average credit losses determined by evaluating a range of possible outcomes and future economic conditions.

The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39, and then a lifetime expected loss allowance is recognised.

IFRS 9 requires the use of more forward looking information including reasonable and supportable forecasts of future economic conditions. The need to consider a range of economic scenarios and how they could impact the loss allowance is a subjective feature of the IFRS 9 ECL model. The Group has developed the capability to model a number of economic scenarios and capture the impact on credit losses to ensure the overall ECL reflects an appropriate distribution of economic outcomes.

For all material portfolios, IFRS 9 ECL calculation will leverage the systems, data and methodology used to calculate regulatory 'expected losses'. The definition of default for IFRS 9 purposes will be aligned to the Basel definition of default to ensure consistency across the Group. IFRS 9 models will use three key input parameters for the computation of expected loss, being probability of default ('PD'), loss given default ('LGD') and exposure at default ('EAD'). However, given the conservatism inherent in the regulatory expected losses calculation and some differences in the period over which risk parameters are measured, some adjustments to these components have been made to ensure compliance with IFRS 9.

Impact on 31 December 2017 balance sheet
It is estimated that the new impairment methodology will result in higher impairment provisions of approximately £1.3 billion, predominantly for loans and advances to customers, recognised on the Group's balance sheet. The re-classification and measurement of assets under IFRS 9 also results in a reduction to the carrying value of financial assets of approximately £0.2 billion gross of tax, mainly as a result of transferring assets managed by the Insurance division to fair value through profit or loss. The total net of tax impact on shareholders' equity is a reduction of approximately £1.1 billion.

The ongoing impact on the financial results will only become clearer after running the IFRS 9 credit risk models over a period of time and under different economic environments, however, it could result in impairment charges being more volatile when compared to the current IAS 39 impairment model, due to the forward looking nature of expected credit losses.

Hedge accounting
The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The standard does not address macro hedge accounting, which is being considered in a separate IASB project. There is an option to retain the existing IAS 39 hedge accounting requirements until the IASB completes its project on macro hedging. The Group expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice.

IFRS 15 Revenue from Contracts with Customers
IFRS 15 replaces IAS 18 'Revenue' and IAS 11 'Construction Contracts' and is effective for annual periods beginning on or after 1 January 2018.

The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. The recognition of such revenue is in accordance with five steps to: identify the contract; identify the performance obligations; determine the transaction price; allocate the transaction price to the performance obligations; and recognise revenue when the performance obligations are satisfied.

In nearly all cases the Group's current accounting policy is consistent with the requirements of IFRS 15, however, certain income streams within the Group's car leasing business will be deferred with effect from 1 January 2018. This results in an additional £14 million being recognised as deferred income at 1 January

49 Future accounting developments (continued)

2018 and a corresponding debit of £11 million, net of tax, to shareholders' equity; as permitted by the transition options under IFRS 15 comparative figures for the prior year have not been restated.

IFRS 16 Leases
IFRS 16 replaces IAS 17 'Leases' and is effective for annual periods beginning on or after 1 January 2019.

IFRS 16 requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessees will recognise a finance charge on the liability and a depreciation charge on the asset which could affect the timing of the recognition of expenses on leased assets. This change will mainly impact the properties that the Group currently accounts for as operating leases. Finance systems will need to be changed to reflect the new accounting rules and disclosures. Lessor accounting requirements remain aligned to the current approach under IAS 17.

Minor amendments to other accounting standards
The IASB has issued a number of minor amendments to IFRSs effective 1 January 2018 (including IFRS 2 Share-based Payment and IAS 40 Investment Property) and effective 1 January 2019 (including IAS 19 Employee Benefits, IAS 12 Income Taxes and IFRIC 23 Uncertainty over Income Tax Treatments). These revised requirements are not expected to have a significant impact on the Group.

50 Other information

Lloyds Bank plc and its subsidiaries form a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

Lloyds Bank 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 Bank, as at 31 December 2017. The list includes each undertaking's registered office and the percentage of the class(es) of shares held by the Group. All shares held are ordinary shares unless indicated otherwise in the notes.

Subsidiary Undertakings

The Bank directly or indirectly holds 100 % of the share class and a majority of voting rights (including where the undertaking does not have share capital as indicated) in the following undertakings.

Name of Undertaking	Notes
A G Finance Ltd	7 ii #
A.C.L. Ltd	1
ACL Autolease Holdings Ltd	1
Alex Lawrie Factors Ltd	9
Alex. Lawrie Receivables Financing Ltd	9
Alexanderplatz 2017 GmbH	87
Amberdate Ltd	1
	iv
AN Vehicle Finance Ltd (In liquidation)	13
Anglo Scottish Utilities Partnership 1	+ *
Aquilus Ltd	1
Automobile Association Personal Finance Ltd	4
Bank of Scotland (B G S) London Nominees Ltd	5 *
Bank of Scotland (Stanlife) London Nominees Ltd	5 *
Bank of Scotland Branch Nominees Ltd	5
Bank of Scotland Capital Funding (Jersey) Ltd	10
Bank of Scotland Central Nominees Ltd	5 *
Bank of Scotland Edinburgh Nominees Ltd	5 *
Bank of Scotland Equipment Finance Ltd	2
Bank of Scotland HongKong Nominees Ltd	11 *
Bank of Scotland Insurance Services Ltd (In liquidation)	85
Bank of Scotland Leasing Ltd	2
Bank of Scotland LNG Leasing (No 1) Ltd (In liquidation)	13
Bank of Scotland London Nominees Ltd	5 *
Bank of Scotland Nominees (Unit Trusts) Ltd	5 *
Bank of Scotland P.E.P. Nominees Ltd	5 *
Bank of Scotland plc	5
	iv
Bank of Scotland Structured Asset Finance Ltd	1
Bank of Scotland Transport Finance 1 Ltd (In liquidation)	13
Bank of Wales Ltd	2
Barents Leasing Ltd	1
Barnwood Mortgages Ltd	12
Bedfont Lakes Business Park (No.2) LP	20 *
Birchcrown Finance Ltd	1 iv
	vi
Birmingham Midshires Asset Management Ltd (In liquidation)	13
Birmingham Midshires Financial Services Ltd	4
Birmingham Midshires Land Development Ltd	4
Birmingham Midshires Mortgage Services Ltd	4
Black Horse (TRF) Ltd	1
Black Horse Executive Mortgages Ltd	1
Black Horse Finance Holdings Ltd	1 i
	ii
Black Horse Finance Management Ltd	1
Black Horse Group Ltd	1
	iv
Black Horse Ltd	1
Black Horse Offshore Ltd	6
Black Horse Property Services Ltd	1
Boltro Nominees Ltd	1
BOS (Ireland) Property Services 2 Ltd	16
BOS (Ireland) Property Services Ltd	16
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Ltd	4
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Ltd	4
BOS (Shared Appreciation Mortgages (Scotland)) Ltd	4

Name of Undertaking	Notes
BOS (Shared Appreciation Mortgages) No. 1 plc	4 #
BOS (Shared Appreciation Mortgages) No. 2 plc	4 #
BOS (Shared Appreciation Mortgages) No. 3 plc	4 #
BOS (Shared Appreciation Mortgages) No. 4 plc	4 #
BOS (Shared Appreciation Mortgages) No. 5 plc	4
BOS (Shared Appreciation Mortgages) No. 6 plc	4
BOS (USA) Fund Investments Inc.	14 xiii
BOS (USA) Inc.	14
BOS Mistral Ltd	2
BOSIC Inc.	18
BOSSAF Rail Ltd	1
Britannia Personal Lending Ltd	4 i #
British Linen Leasing (London) Ltd	5
British Linen Leasing Ltd	5
British Linen Shipping Ltd	5
C & G Homes Ltd (In liquidation)	13
C&G Estate Agents Ltd	12
C.T.S.B. Leasing Ltd (In liquidation)	13
Capital 1945 Ltd	2
Capital Bank Insurance Services Ltd (In liquidation)	13
Capital Bank Leasing 1 Ltd	2
Capital Bank Leasing 2 Ltd	2
Capital Bank Leasing 3 Ltd	2
Capital Bank Leasing 4 Ltd	2
Capital Bank Leasing 5 Ltd	2
Capital Bank Leasing 6 Ltd	2
Capital Bank Leasing 7 Ltd	2
Capital Bank Leasing 8 Ltd	17
Capital Bank Leasing 9 Ltd	2
Capital Bank Leasing 10 Ltd	2
Capital Bank Leasing 11 Ltd	2
Capital Bank Leasing 12 Ltd	5
Capital Bank Property Investments (3) Ltd	2
Capital Bank Vehicle Management Ltd	2
Capital Leasing (Edinburgh) Ltd	17
Capital Leasing Ltd (In liquidation)	85
Capital Personal Finance Ltd	4
Car Ownership Finance Ltd (In liquidation)	13
Cardnet Merchant Services Ltd	1 ii, #
	iii ^
Carlease Ltd	1
Cartwright Finance Ltd	2 viii
	vii #
Cashfriday Ltd	9
Cashpoint Ltd	1
Caveminster Ltd	1
CBRail S.A.R.L.	19
Cedar Holdings Ltd	1
Central Mortgage Finance Ltd	12
CF Asset Finance Ltd	2
Chariot Finance Ltd (In liquidation)	13
Chartered Trust (Nominees) Ltd	1
Charterhall (No. 1) Ltd (In liquidation)	13
Charterhall (No. 2) Ltd (In liquidation)	13
Cheltenham & Gloucester plc	12
Chiswell Stockbrokers Ltd	1
Clerical Medical (Dartford Number 2) Ltd	20
Clerical Medical (Dartford Number 3) Ltd	20
Clerical Medical Finance plc	20
Clerical Medical Financial Services Ltd	20
Clerical Medical Forestry Ltd	20
Clerical Medical International Holdings B.V.	21
Clerical Medical Investment Fund Managers Ltd	4
Clerical Medical Managed Funds Ltd	20
Clerical Medical Non Sterling Property Company SARL	22
Clerical Medical Properties Ltd	20

Subsidiaries and related undertakings

Name of Undertaking	Notes
Cloak Lane Funding Ltd	6
	iv
Cloak Lane Investments Ltd	6
CM Venture Investments Ltd	23
	iv
CMI Insurance (Luxembourg) S.A. (In liquidation)	24
Conquest Securities Ltd	1 iv
	vi
Corbiere Asset Investments Ltd	1 i
	ii
Create Services Ltd	1
Dalkeith Corporation	25
Delancey Rolls UK Ltd (In liquidation)	26 i
Direct LB Ltd (in liquidation)	13
Dunstan Investments (UK) Ltd	1
Enterprise Car Finance Ltd	7 ii #
Eurolead Services Holdings Ltd	9
Exclusive Finance No. 1 Ltd (In liquidation)	13 i
Financial Consultants LB Ltd	1
First Retail Finance (Chester) Ltd	4
Flexifly Ltd (in liquidation)	85
Fontview Ltd	20
Forthright Finance Ltd	2
France Industrial Premises Holding Company	28
Freeway Ltd(In liquidation)	2
General Leasing (No. 4) Ltd	1
General Leasing (No. 12) Ltd	1
General Reversionary and Investment Company	20
Glosstrips Ltd (In liquidation)	85
Godfrey Davis (Contract Hire) Ltd	2
Gresham Nominee 1 Ltd	1
Gresham Nominee 2 Ltd	1
Halifax Credit Card Ltd	4 i
	ii
	vii
Halifax Equitable Ltd	4
Halifax Financial Brokers Ltd	4
Halifax Financial Services (Holdings) Ltd	4
Halifax Financial Services Ltd	4
Halifax General Insurance Services Ltd	4
Halifax Group Ltd	4
Halifax Investment Services Ltd	4
Halifax Leasing (June) Ltd	1
Halifax Leasing (March No.2) Ltd	1
Halifax Leasing (September) Ltd	1
Halifax Life Ltd	4
Halifax Ltd	4
Halifax Loans Ltd	4
Halifax Mortgage Services (Holdings) Ltd	4
Halifax Mortgage Services Ltd	4
Halifax Nominees Ltd	4
Halifax Pension Nominees Ltd	29
Halifax Premises Ltd	1
Halifax Share Dealing Ltd	4
Halifax Vehicle Leasing (1998) Ltd	4
HBOS Canada Inc.	18
HBOS Capital Funding (Jersey) Ltd	10
HBOS Covered Bonds LLP	4 *
HBOS Directors Ltd (In liquidation)	13
HBOS Final Salary Trust Ltd	5
HBOS Financial Services Ltd	20
HBOS Insurance & Investment Group Ltd	20
HBOS International Financial Services Holdings Ltd	20
HBOS Investment Fund Managers Ltd	4
HBOS Management (Jersey) Ltd	10
HBOS plc	5

Name of Undertaking	Notes
	iv
	vi
HBOS Social Housing Covered Bonds LLP	2 *
HBOS Treasury Services Ltd (In liquidation)	13
HBOS UK Ltd	5
Heidi Finance Holdings (UK) Ltd	1
Hill Samuel (USA), Inc.	14
Hill Samuel Bank Ltd	1
Hill Samuel Finance Ltd	1 iv
	xi
Hill Samuel Leasing (No 2) Ltd (In liquidation)	13
Hill Samuel Leasing Co. Ltd	1
Hill Samuel Nominees Asia Private Ltd	31
HL Group (Holdings) Ltd (In liquidation)	13
Home Shopping Personal Finance Ltd	4
Horizon Capital Ltd (In liquidation)	85
Horsham Investments Ltd	6
HSDL Nominees Ltd	4
HVF Ltd	2
Hyundai Car Finance Ltd	7 i
	ii
IAI International Ltd (In liquidation)	1
IBOS Finance Ltd	2
ICC Enterprise Partners Ltd (In liquidation)	32
ICC Equity Partners Ltd (In liquidation)	32
ICC ESOP Trustee Ltd (In liquidation)	33
ICC Holdings Unlimited Company	16
ICC Software Partners Ltd (In liquidation)	32
IF Covered Bonds Limited Liability Partnership (In liquidation)	67 *
Inchcape Financial Services Ltd	2 i #
Industrial Real Estate LP	34 *
Industrial Real Estate (General Partner) Ltd	34
Industrial Real Estate (Nominee) Ltd	34
Intelligent Finance Financial Services Ltd	4
Intelligent Finance Software Ltd	4
International Motors Finance Ltd	2 i #
Kanaalstraat Funding C.V.	35
Kanto Leasing Ltd (In liquidation)	13
Katrine Leasing Ltd	36
LB Comhold Ltd (In liquidation)	13
LB Healthcare Trustee Ltd	1
LB Leasing L.P	38 *
LB Motorent Ltd	1
LB Quest Ltd	1
LB Share Schemes Trustees Ltd	1
LBCF Ltd	9
LBG Brasil Administração LTDA	46
LBI Leasing Ltd	1
LBPB (21 Hill Street) Ltd (In liquidation)	13
Leasing (No. 2) Ltd (In liquidation)	13
Legacy Renewal Company Ltd	5
Lex Autolease (CH) Ltd	1
Lex Autolease (FMS) Ltd (In liquidation)	13
Lex Autolease (Shrewsbury) Ltd (In liquidation)	13
	iv
	v
Lex Autolease (VC) Ltd	1
Lex Autolease Carselect Ltd	1
Lex Autolease Ltd	1
Lex Vehicle Finance 2 Ltd	2
Lex Vehicle Finance 3 Ltd	2
Lex Vehicle Finance Ltd (In liquidation)	13
Lex Vehicle Leasing (Holdings) Ltd	2 i
	ii
	x
Lex Vehicle Leasing Ltd	2

Subsidiaries and related undertakings

Name of Undertaking	Notes
Lex Vehicle Partners (1) Ltd (In liquidation)	13
Lex Vehicle Partners (2) Ltd (In liquidation)	13
Lex Vehicle Partners (3) Ltd (In liquidation)	13
Lex Vehicle Partners (4) Ltd (In liquidation)	13
Lex Vehicle Partners Ltd (In liquidation)	13
Lime Street (Funding) Ltd	1
Lloyds (FDC) Company (In liquidation)	13
Lloyds (General Partner) Ltd	6
Lloyds (Gresham) Ltd	1
	x
Lloyds (Gresham) No. 1 Ltd	1
Lloyds (Nimrod) Leasing Industries Ltd (In liquidation)	13
Lloyds (Nimrod) Specialist Finance Ltd	1
Lloyds America Securities Corporation	14
Lloyds Asset Leasing Ltd	1
Lloyds Bank (BLSA) (In liquidation)	13
Lloyds Bank (Branches) Nominees Ltd	1
Lloyds Bank (Colonial & Foreign) Nominees Ltd	1
Lloyds Bank (Fountainbridge 1) Ltd	5
Lloyds Bank (Fountainbridge 2) Ltd	5
Lloyds Bank (Gibraltar) Ltd	39
Lloyds Bank (I.D.) Nominees Ltd	1
Lloyds Bank (PEP Nominees) Ltd	1
Lloyds Bank (Stock Exchange Branch) Nominees Ltd	1
Lloyds Bank Asset Finance Ltd	1
Lloyds Bank Commercial Finance Ltd	9
Lloyds Bank Commercial Finance Scotland Ltd	40
Lloyds Bank Corporate Asset Finance (HP) Ltd	1
Lloyds Bank Corporate Asset Finance (No.1) Ltd	1
Lloyds Bank Corporate Asset Finance (No. 2) Ltd	1
Lloyds Bank Corporate Asset Finance (No.3) Ltd	1
Lloyds Bank Corporate Asset Finance (No.4) Ltd	1
Lloyds Bank Covered Bonds LLP	41 *
Lloyds Bank Equipment Leasing (No. 1) Ltd	1
Lloyds Bank Equipment Leasing (No. 5) Ltd (In liquidation)	13
Lloyds Bank Equipment Leasing (No. 7) Ltd	1
Lloyds Bank Equipment Leasing (No. 9) Ltd	1
Lloyds Bank Equipment Leasing (No. 10) Ltd (In liquidation)	13
Lloyds Bank Equipment Leasing (No. 11) Ltd (In liquidation)	13
Lloyds Bank Financial Advisers Ltd	1 i
	ii
Lloyds Bank Financial Services (Holdings) Ltd	1
	iv
Lloyds Bank General Insurance Holdings Ltd	42
Lloyds Bank General Insurance Ltd	1
Lloyds Bank General Leasing (No. 1) Ltd (In liquidation)	13
Lloyds Bank General Leasing (No. 3) Ltd	1
Lloyds Bank General Leasing (No. 5) Ltd	1
Lloyds Bank General Leasing (No. 9) Ltd (In liquidation)	13
Lloyds Bank General Leasing (No. 11) Ltd	1
Lloyds Bank General Leasing (No. 17) Ltd	1
Lloyds Bank General Leasing (No. 18) Ltd (In liquidation)	13
Lloyds Bank General Leasing (No. 20) Ltd (In liquidation)	13
Lloyds Bank Hill Samuel Holding Company Ltd	1
Lloyds Bank Insurance Services (Direct) Ltd	1
Lloyds Bank Insurance Services Ltd	1
Lloyds Bank International Ltd	6
Lloyds Bank Leasing (No. 3) Ltd (In liquidation)	13
Lloyds Bank Leasing (No. 4) Ltd (In liquidation)	13
Lloyds Bank Leasing (No. 6) Ltd	1
Lloyds Bank Leasing (No. 7) Ltd (In liquidation)	13
Lloyds Bank Leasing (No. 8) Ltd	1
Lloyds Bank Leasing Ltd	1
Lloyds Bank Maritime Leasing (No. 2) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 8) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 10) Ltd	1

Name of Undertaking	Notes
Lloyds Bank Maritime Leasing (No. 12) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 13) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 15) Ltd	1
Lloyds Bank Maritime Leasing (No.16) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 17) Ltd	1
Lloyds Bank Maritime Leasing (No. 18) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing Ltd (In liquidation)	13
Lloyds Bank MTCH Ltd	1
Lloyds Bank Nominees Ltd	1
Lloyds Bank Offshore Pension Trust Ltd	6
Lloyds Bank Pension ABCS (No. 1) LLP	1 *
Lloyds Bank Pension ABCS (No. 2) LLP	1 *
Lloyds Bank Pension Trust (No. 1) Ltd	1
Lloyds Bank Pension Trust (No. 2) Ltd	1
Lloyds Bank Pensions Property (Guernsey) Ltd	37 i
	ii
Lloyds Bank Properties Ltd	1
Lloyds Bank Property Company Ltd	1
Lloyds Bank S.F. Nominees Ltd	1
Lloyds Bank Subsidiaries Ltd	1
Lloyds Bank Trust Company (International) Ltd	1
Lloyds Bank Trustee Services Ltd	1
Lloyds Banking Group Pensions Trustees Ltd	1
Lloyds Commercial Leasing Ltd (In liquidation)	13
Lloyds Commercial Properties Ltd	1
Lloyds Commercial Property Investments Ltd	1
Lloyds Corporate Services (Jersey) Ltd	6
Lloyds Engine Capital (No.1) U.S LLC	14 *
Lloyds Far East Ltd	43
Lloyds Financial Leasing Ltd (In liquidation)	13
Lloyds General Leasing Ltd	1
Lloyds Group Holdings (Jersey) Ltd	44 i #
	ii
	vii
Lloyds Holdings (Jersey) Ltd	6
Lloyds Industrial Leasing Ltd	1
Lloyds International Pty Ltd	8
Lloyds Investment Bonds Ltd	1
Lloyds Investment Fund Managers Ltd	6
Lloyds Investment Securities No.5 Ltd	1
Lloyds Leasing (North Sea Transport) Ltd	1
Lloyds Leasing Developments Ltd	1
Lloyds Merchant Bank Asia Ltd	31
	iv
Lloyds Nominees (Guernsey) Ltd	37
Lloyds Offshore Global Services Private Ltd	45
Lloyds Plant Leasing Ltd	1
Lloyds Portfolio Leasing Ltd	1
Lloyds Premises Investments Ltd	1
Lloyds Project Leasing Ltd	1
Lloyds Property Investment Company No. 3 Ltd (In liquidation)	13
Lloyds Property Investment Company No. 4 Ltd	1
Lloyds Property Investment Company No.5 Ltd	1
Lloyds Secretaries Ltd	1
Lloyds Securities Inc.	14
Lloyds Trust Company (Gibraltar) Ltd	39
Lloyds TSB Pacific Ltd	51
Lloyds UDT Asset Leasing Ltd	1
Lloyds UDT Asset Rentals Ltd	1
Lloyds UDT Business Development Ltd	1
Lloyds UDT Business Equipment Ltd	1
Lloyds UDT Hiring Ltd	1
Lloyds UDT Leasing Ltd	1
Lloyds UDT Ltd	1
Lloyds UDT Rentals Ltd (In liquidation)	49
Lloyds Your Tomorrow Trustee Ltd	1

Subsidiaries and related undertakings

Name of Undertaking	Notes
Loans.Co.UK Ltd	79
London Taxi Finance Ltd	1 i
	ii
London Uberior (L.A.S. Group) Nominees Ltd	5 *
Lotus Finance Ltd	76 i #
LTGP Limited Partnership Incorporated	37 *
Mainsearch Company Ltd	79
Maritime Leasing (No. 19) Ltd	1
MBNA Direct Limited	79
MBNA Europe Finance Ltd	80
MBNA Europe Holdings Ltd	79
MBNA Global Services Ltd	79
MBNA Indian Services Private Ltd	81
MBNA Ltd	79
MBNA R & L S.A.R.L.	82
MBNA Receivables Ltd	60
Meadowfield Investments Ltd (In liquidation)	85
Membership Services Finance Ltd	4
Mitre Street Funding Ltd	6
Moor Lane Holdings Ltd	6
Moray Investments Ltd (In liquidation)	13
Newfont Ltd	20
NFU Mutual Finance Ltd	2 i #
	vii
Nominees (Jersey) Ltd	6
Nordic Leasing Ltd	1
NWS Trust Ltd	5
Ocean Leasing (July) Ltd (In liquidation)	13
Ocean Leasing (No 1) Ltd (In liquidation)	13
Ocean Leasing (No 2) Ltd (In liquidation)	13
Oystercatcher LP	20 *
Oystercatcher Nominees Ltd	20
Oystercatcher Residential Ltd	20
Pacific Leasing Ltd	1
Paneldeluxe Company Limited (In liquidation)	83
Pensions Management (S.W.F.) Ltd	51 *
Peony Eastern Leasing Ltd	1
Peony Leasing Ltd	1
Peony Western Leasing Ltd	1
Perry Nominees Ltd	1
PIPS Asset Investments Ltd	1 i
	ii
Portland Funding Ltd (In liquidation)	13
Proton Finance Ltd	7 ii #
Quion 6 BV	52
R.F. Spencer And Company Ltd	2
Ranelagh Nominees Ltd	1
Retail Revival (Burgess Hill) Investments Ltd	1
Saint Michel Holding Company No1	28
Saint Michel Investment Property	28
Saint Witz 2 Holding Company No1	28
Saint Witz 2 Investment Property	28
Saleslease Purchase Ltd (In liquidation)	85
Sapphire Cards Limited (In liquidation)	83
Savban Leasing Ltd	1
Scotland International Finance B.V.	21
Scotmar Commercial Equipment Finance Ltd (In liquidation)	13 i #
Scottish Widows (Port Hamilton) Ltd	51
Scottish Widows Active Management Fund	3 *
Scottish Widows Administration Services Ltd	1
Scottish Widows Annuities Ltd	3
Scottish Widows Financial Services Holdings	3
Scottish Widows Fund and Life Assurance Society	51 *
Scottish Widows Fund Management Ltd	51
Scottish Widows Group Ltd	3 i
	ii

Name of Undertaking	Notes
	iv
	x
Scottish Widows Industrial Properties Europe B.V.	53
Scottish Widows Ltd	1
Scottish Widows Pension Trustees Ltd	3
Scottish Widows Property Management Ltd	51
Scottish Widows Services Ltd	3
Scottish Widows Trustees Ltd	51
Scottish Widows Unit Funds Ltd	3
Scottish Widows Unit Trust Managers Ltd	42
Seabreeze Leasing Ltd	1
Seaforth Maritime (Highlander) Ltd (In liquidation)	85
Seaforth Maritime (Jarl) Ltd (In liquidation)	85
Seaspirit Leasing Ltd	1
Seaspray Leasing Ltd (In liquidation)	13
Services LB (No. 2) Ltd (In liquidation)	13
	iv
Share Dealing Nominees Ltd	4
Shogun Finance Ltd	7 ii #
Silentdale Ltd	1 iv
	vi
	vi
St Andrew's Group Ltd	20
St Andrew's Insurance plc	20
St Andrew's Life Assurance plc	20
St. Mary's Court Investments	1
Standard Property Investment (1987) Ltd	17 i
	ii
Standard Property Investment Ltd	54 #
Starfort Ltd	20
Sussex County Homes Ltd	4
Suzuki Financial Services Ltd	76 i #
SWB (67 Morrison Street) PLC	86
SW No.1 Ltd	3
SWAMF (GP) Ltd	20
SWAMF Nominee (1) Ltd	20
SWAMF Nominee (2) Ltd	20
SW Funding plc	3 #
Target Corporate Services Ltd	1
The Agricultural Mortgage Corporation plc	45
The British Linen Company Ltd	5
The Mortgage Business plc	4
Thistle Leasing	+ *
Three Copthall Avenue Ltd	1
Tower Hill Property Investments (7) Ltd	2 #
Tower Hill Property Investments (10) Ltd	2 #
Tranquility Leasing Ltd	1
Uberior Canada LP Ltd	55
Uberior ENA Ltd	17
Uberior Infrastructure Investments Ltd	5
Uberior Infrastructure Investments (No.2) Ltd	1
Uberior Nominees Ltd	5 *
Uberior Trustees Ltd	5 *
UDT Autolease Ltd	1
UDT Budget Leasing Ltd	1
UDT Ltd	1
UDT Sales Finance Ltd	1
United Dominions Leasing Ltd	1
United Dominions Trust Ltd	1
Universe, The CMI Global Network Fund	89 *
Upsaala Ltd	16
Vehicle Leasing (1) Ltd (In liquidation)	13
Vehicle Leasing (2) Ltd (In liquidation)	13
Vehicle Leasing (3) Ltd (In liquidation)	13
Vehicle Leasing (4) Ltd (In liquidation)	13
Ward Nominees (Abingdon) Ltd	1

Subsidiaries and related undertakings

Name of Undertaking	Notes
Ward Nominees (Birmingham) Ltd	1
Ward Nominees (Bristol) Ltd	1
Ward Nominees Ltd	1
Warwick Leasing Ltd (In liquidation)	13
Waverley – Fund II Investor LLC	25
Waverley – Fund III Investor LLC	25
Waymark Asset Investments Ltd	1 i

Name of Undertaking	Notes
	ii
WCS Ltd	57
Western Trust & Savings Holdings Ltd (In liquidation)	13
Western Trust Holdings Ltd (In liquidation)	13
Whitestar Securities Ltd (In liquidation)	13 ii
	xi
Wood Street Leasing Ltd	1

Subsidiary Undertakings (continued)

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

Name of Undertaking	Notes
Addison Social Housing Holdings Ltd	58
ARKLE Finance Trustee Ltd	10
ARKLE Funding (No. 1) Ltd	59
ARKLE Holdings Ltd	59
ARKLE Master Issuer plc	59
ARKLE PECOH Holdings Ltd	59
ARKLE PECOH Ltd	59
Cancara Asset Securitisation Ltd	60
Candide Financing 2007 NHG BV	61
Candide Financing 2008-1 BV	61
Candide Financing 2008-2 BV	61
Candide Financing 2011-1 BV	61
Candide Financing 2012-1 BV	61
Cardiff Auto Receivables Securitisation 2018-1 Plc	41
Cardiff Auto Receivables Securitisation Holdings Ltd	41
Celsius European Lux 2 SARL	88
Cheltenham Securities 2017 Ltd	58
Chepstow Blue Holdings Ltd	41
Chepstow Blue plc	41
Chester Asset Options No.2 Ltd	66
Chester Asset Options No.3 Ltd	84
Chester Asset Receivables Dealings Issuer Ltd	60
Chester Asset Securitisation Holdings Ltd	66
Chester Asset Securitisation Holdings No.2 Ltd	60
Clerical Medical Non Sterling Arts FSA	62
Clerical Medical Non Sterling Arts LSA	62
Clerical Medical Non Sterling Guadalix Hold Co BV	63
Clerical Medical Non Sterling Guadalix Spanish Prop Co SL	64
Clerical Medical Non Sterling Megapark Hold Co BV	63
Clerical Medical Non Sterling Megapark Prop Co SA	64
Credit Card Securitisation Europe Ltd	60
Deva Financing Holdings Ltd	41
Deva Financing plc	41
Deva One Ltd	60
Deva Three Ltd	60
Deva Two Ltd	60
Edgbaston RMBS 2010-1 plc	41
Edgbaston RMBS Holdings Ltd	41
Fontwell Securities 2016 Ltd	58
Gresham Receivables (No. 1) Ltd	60
Gresham Receivables (No. 3) Ltd	60
Gresham Receivables (No. 10) Ltd	60
Gresham Receivables (No.11) UK Ltd	66
Gresham Receivables (No. 12) Ltd	60
Gresham Receivables (No. 13) UK Ltd	66
Gresham Receivables (No. 14) UK Ltd	66
Gresham Receivables (No. 15) UK Ltd	66
Gresham Receivables (No. 16) UK Ltd	66
Gresham Receivables (No. 19) UK Ltd	66
Gresham Receivables (No. 20) Ltd	60
Gresham Receivables (No. 21) Ltd	60
Gresham Receivables (No. 22) Ltd	60
Gresham Receivables (No. 23) Ltd	60

Name of Undertaking	Notes
Gresham Receivables (No. 24) Ltd	60
Gresham Receivables (No. 25) UK Ltd	66
Gresham Receivables (No. 26) UK Ltd	66
Gresham Receivables (No.27) UK Ltd	66
Gresham Receivables (No.28) Ltd	60
Gresham Receivables (No.29) Ltd	60
Gresham Receivables (No. 30) UK Ltd	66
Gresham Receivables (No. 31) UK Ltd	66
Gresham Receivables (No. 32) UK Ltd	66
Gresham Receivables (No. 33) UK Ltd	66
Gresham Receivables (No. 34) UK Ltd	66
Gresham Receivables (No.35) Ltd	60
Gresham Receivables (No.36) UK Ltd	66
Gresham Receivables (No.37) UK Ltd	66
Gresham Receivables (No.38) UK Ltd	66
Gresham Receivables (No.39) UK Ltd	66
Gresham Receivables (No.40) UK Ltd	66
Gresham Receivables (No.41) UK Ltd	66
Gresham Receivables (No. 42) Ltd	60
Gresham Receivables (No.44) UK Ltd	66
Gresham Receivables (No.45) UK Ltd	66
Gresham Receivables (No.46) UK Ltd	66
Gresham Receivables (No.47) UK Ltd	66
Guildhall Asset Purchasing Company (No 3) Ltd	60
Guildhall Asset Purchasing Company (No.11) UK Ltd	66
Hart 2014-1 Ltd	36
Leicester Securities 2014 Ltd	68
Lingfield 2014 I Holdings Ltd	41
Lingfield 2014 I plc	41
Lloyds Bank Covered Bonds (Holdings) Ltd	41
Lloyds Bank Covered Bonds (LM) Ltd	41
Molineux RMBS 2016-1 plc	41
Molineux RMBS Holdings Ltd	41
Penarth Asset Securitisation Holdings Ltd	41
Penarth Funding 1 Ltd	58
Penarth Funding 2 Ltd	58
Penarth Master Issuer plc	41
Penarth Receivables Trustee Ltd	58
Permanent Funding (No. 1) Ltd	41
Permanent Funding (No. 2) Ltd	41
Permanent Holdings Ltd	41
Permanent Master Issuer plc	41
Permanent Mortgages Trustee Ltd	41
Permanent PECOH Holdings Ltd	41
Permanent PECOH Ltd	41
Salisbury Securities 2015 Ltd	58
Salisbury II Securities 2016 Ltd	58
Salisbury II-A Securities 2017 Ltd	58
Sandown 2012-2 Holdings Ltd	41
Sandown 2012-2 plc	41
Sandown Gold 2011-1 Holdings Ltd	42
Sandown Gold 2011-1 plc (In liquidation)	69
Sandown Gold 2012-1 Holdings Ltd	41

Subsidiaries and related undertakings

Name of Undertaking	Notes
Sandown Gold 2012-1 plc	41
SARL Coliseum	72
SARL Fonciere De Rives	72
SARL Hiram	72
SAS Compagnie Fonciere De France	72
SCI Astoria Invest	72
SCI De L'Horloge	72
SCI Equinoxe	72
SCI Mercury Invest	72
SCI Millenium AP1	72
SCI Norli	72
SCI Rambuteau CFF	72
Stichting Candide Financing Holding	61
Swan Funding 2 Ltd	58
Thistle Investments (AMC) Ltd	41
Thistle Investments (ERM) Ltd	41
Trinity Financing Holdings Ltd	41
Trinity Financing plc	41
Wetherby Securities 2017 Ltd	58
Lloyds Bank Foundation for England & Wales •	74
The Halifax Foundation for Northern Ireland •	15
Lloyds Bank Foundation for the Channel Islands•	74
Lloyds TSB Foundation for Scotland •	75
Bank of Scotland Foundation •	5
MBNA General Foundation •	79

• A charitable foundation funded but not owned by Lloyds Banking Group

Associated Undertakings

The Group has a participating interest in the following undertakings.

Name of Undertaking	% of share class held by immediate parent company (or by the Group where this varies)	Registered office address (UK unless stated otherwise)	Notes
Addison Social Housing Ltd	20%	35 Great St Helen's, London, EC3A 6AP	
Aspire Oil Services Ltd	28.4%	Bishop's Court, 29 Albyn Place, Aberdeen, AB10 1YL, United Kingdom	&
Cary Towne Parke Holdings LLC	n/a	Jeffrey Cohen, 1066 Woodward Avenue, Detroit, MI 48226, United States	*
Cary Towne Parke LLC	n/a	100 Galleria Officentre, Suite 419, Southfield MI 48034, United States	*
Chester Business Park Management Company Ltd	24%	Drake House, Gadbrook Park, Rudheath, Northwich, CW9 7TW, United Kingdom	
Connery Ltd	20%	44 Esplanade St Helier Jersey JE4 9WG	&
Delancey Arnold UK Ltd (In liquidation)	50%	4th Floor, 4 Victoria Square, St Albans, AL1 3TF, United Kingdom	
Great Wigmore Property Ltd	50%	33 Cavendish Square, London, W1G 0PW	&
Motability Operations Group plc	20% (40%) 20% (40%)	City Gate House, 22 Southwark Bridge Road, London, SE1 9HB	iv
Northern Edge Ltd	39.4%	The Beacon, 176 St. Vincent Street, Glasgow, G2 5SG	ii &
Omnium Leasing Company	39%	N/A	+
Rolls Development UK Ltd (In Liquidation)	50%	4th Floor , 4 Victoria Square, St Albans, Hertfordshire, AL1 3TF, United Kingdom	√ ii
The Great Wigmore Partnership (G.P.) Ltd	50%	33 Cavendish Square, London, W1G 0PW	
The Great Wigmore Partnership	n/a	33 Cavendish Square, London, W1G 0PW	*
Thread Real Estate Cary Towne Park LLC	n/a	Corporation Trust Centre, 1209 Orange Street, Wilmington, DE 19801, United States	
Travellers Cheque Associates Ltd	36%	Belgrave House, 76 Buckingham Palace Road, London, SW1W 9AX	

*	The undertaking does not have share capital
+	The undertaking does not have a registered office
#	In relation to Subsidiary Undertakings, an undertaking external to the Group holds shares
^	Shares held directly by Lloyds Bank plc
&	The Group holds voting rights of between 20% and 49.9%
(i)	A Ordinary shares
(ii)	B Ordinary shares
(iii)	Deferred shares
(iv)	Preference shares
(v)	Preferred ordinary shares
(vi)	Non-voting shares
(vii)	C Ordinary shares
(viii)	N Ordinary shares
(ix)	Callable preference shares
(x)	Redeemable preference shares
(xi)	Ordinary limited voting shares
(xii)	Redeemable ordinary shares
(xiii)	Common stock

Collective Investment Vehicles

The following comprises a list of the Group's and other external collective investment vehicles (CIV), where the shareholding is greater than or equal to 20% of the nominal value of any class of shares, or a book value greater than 20% of the CIV's assets.

Name of Undertaking	% of fund held by immediate parent (or by the Group where this varies)	Notes
ABERDEEN INVESTMENT ICVC		8
Aberdeen European Property Share Fund	56.79%	
Aberdeen Sterling Bond Fund	77.36%	
Aberdeen European Global High Yield Bond Fund	24.25%	
Aberdeen Sterling Opportunistic Corporate Bond Fund	34.58%	
ABERDEEN INVESTMENTS ICVC II		8
Aberdeen Global Corporate Bond Tracker Fund	97.86%	
ABERDEEN INVESTMENT ICVC III		8
Aberdeen Global Emerging Markets Quantitative Equity Fund	70.62%	
ABERDEEN LIQUIDITY FUND (LUX)		7
Aberdeen Liquidity Fund (Lux) - Sterling Fund	52.49%	
Aberdeen Liquidity Fund (Lux) - Euro Fund	20.88%	
Aberdeen Liquidity Fund (Lux) - Ultra Short Duration Sterling Fund	61.20%	
ABERDEEN PRIVATE EQUITY FUND OF FUNDS (2007) PLC	96.08%	3
ACS POOLED PROPERTY		2
Scottish Widows Pooled Property ACS Fund	100%	
Scottish Widows Pooled Property ACS Fund2	100%	
BLACKROCK BALANCED GROWTH PORTFOLIO FUND	42.06%	9
BLACKROCK UK SMALLER COMPANIES FUND	23.09%	9
BNY MELLON INVESTMENTS FUNDS ICVC		10
Insight Global Multi-Strategy Fund	43.84%	
Insight Global Absolute Return Fund	73.62%	
Newton Multi-Asset Growth Fund	29.15%	
Newton UK Opportunities Fund	42.36%	
Newton UK Income Fund	27.38%	
HBOS ACTIVELY MANAGED PORTFOLIO FUNDS ICVC		1
Diversified Return Fund	94.47%	
Absolute Return Fund	92.49%	
Dynamic Return Fund	96.56%	
HBOS INTERNATIONAL INVESTMENT FUNDS ICVC		1
North American Fund	96.49%	
Far Eastern Fund	81.71%	
European Fund	94.19%	
International Growth Fund	53.63%	
Japanese Fund	95.80%	
HBOS SPECIALISED INVESTMENT FUNDS ICVC		1
Cautious Managed Fund	52.61%	
Ethical Fund	83.59%	
Fund of Investment Trusts	40.57%	
Smaller Companies Fund	66.86%	
Special Situations Fund	51.67%	
HBOS UK INVESTMENT FUNDS ICVC		1
UK Equity Income Fund	62.43%	
UK Growth Fund	62.36%	
UK FTSE All-Share Index Tracking Fund	58.47%	
HBOS PROPERTY INVESTMENT FUNDS ICVC		1
UK Property Fund	40.50%	
HLE ACTIVE MANAGED PORTFOLIO KONSERVATIV	32.65%	16
HLE ACTIVE MANAGED PORTFOLIO DYNAMISCH	53.98%	16
HLE ACTIVE MANAGED PORTFOLIO AUSGEWOGEN	58.43%	16
INSIGHT INVESTMENT FUND OF FUNDS II ICVC		11
Absolute Insight Fund	61.29%	
INVESCO PERPETUAL FAR EASTERN INVESTMENT SERIES		12
Invesco Perpetual Asian Equity Income Fund	24.38%	
LDI Solutions Plus plc		17
IIFIG Government Liquidity Fund	21.81%	
MULTI MANAGER ICVC		2
Multi Manager UK Equity Growth Fund	82.23%	
Multi Manager UK Equity Income Fund	29.30%	
Multi Manager UK Equity Focus Fund	21.50%	
RUSSELL INVESTMENT COMPANY PLC		13
Russell Euro Fixed Income Fund	29.73%	
Russell Sterling Bond Fund	38.48%	
Russell U.S. Bond Fund	48.73%	
SCHRODER GILT AND FIXED INTEREST FUND	23.75%	14
SCOTTISH WIDOWS INCOME AND GROWTH FUNDS ICVC		2
UK Index Linked Gilt Fund	100%	
Corporate Bond PPF Fund	100%	
SW Corporate Bond Tracker	100%	
Scottish Widows GTAA 1	84.39%	
Corporate Bond 1 Fund	100%	
Balanced Growth Fund	27.17%	
Adventurous Growth Fund	71.69%	
SCOTTISH WIDOWS INVESTMENT SOLUTIONS FUNDS ICVC		2
Balanced Solution	45.76%	
Cautious Solution	37.40%	
Discovery Solution	45.42%	
Strategic Solution	55.13%	
Dynamic Solution	57.85%	
Defensive Solution	68.08%	
Adventurous Solution	76.79%	
European (ex UK) Equity Fund	96.77%	
Asia Pacific (ex Japan) Equity Fund	95.74%	
Japan Equities Fund	94.71%	
US Equities Fund	99.71%	
Fundamental Index UK Equity Fund	85.30%	
Fundamental Index Global Equity Fund	96.68%	
Fundamental Index Emerging Markets Equity Fund	95.50%	
Fundamental Low Volatility Index Global Equity	98.39%	
Fundamental Low Volatility Index Emerging Markets Equity	96.17%	
Fundamental Low Volatility Index UK Equity	91.85%	
SCOTTISH WIDOWS MANAGED INVESTMENT FUNDS ICVC		2
International Equity Tracker Fund	77.65%	
Balanced Portfolio Fund	82.19%	
Progressive Portfolio Fund	72.76%	
Cautious Portfolio Fund	60.17%	
Cash Fund	99.06%	
Opportunities Portfolio Fund	92.18%	
SCOTTISH WIDOWS OVERSEAS GROWTH INVESTMENT FUNDS ICVC		2
Global Growth Fund	54.22%	
European Growth Fund	90.07%	

Subsidiaries and related undertakings

Name of Undertaking	% of fund held by immediate parent (or by the Group where this varies)	Notes
American Growth Fund	87.81%	
Pacific Growth Fund	76.54%	
Japan Growth Fund	98.62%	
SCOTTISH WIDOWS TRACKER AND SPECIALIST INVESTMENT FUNDS ICVC		2
UK All Share Tracker Fund	92.70%	
International Bond Fund	32.96%	
UK Smaller Companies Fund	28.56 %	
UK Tracker Fund	47.44%	
UK Fixed Interest Tracker Fund	96.28%	
Emerging Markets Fund	89.40%	
UK Index-Linked Tracker Fund	50.89%	
Overseas Fixed Interest Tracker Fund	94.23%	
SCOTTISH WIDOWS UK AND INCOME INVESTMENT FUNDS ICVC		2
UK Corporate Bond Fund	62.79%	
UK Growth Fund	62.02%	
Gilt Fund	95.99%	
High Income Bond Fund	25.77%	
Strategic Income Fund	63.23%	
Environmental Investor Fund	69.89%	
Ethical Fund	73.65%	
SSGA ASIA PACIFIC TRACKER FUND	86.64%	4
SSGA EUROPE (EX UK)	96.10%	4
SSGA UK EQUITY TRACKER FUND	92.43%	4
SSGA NORTH AMERICAN EQUITY FUND	100%	4
SWIP EUROPEAN BALANCED PROPERTY FUND	84.64%	5
UNIVERSE, THE CMI GLOBAL NETWORK		6
CMIG GA 70 Flexible	100%	
CMIG GA 80 Flexible	100%	
CMIG GA 90 Flexible	100%	
EURO CAUTIOUS	90.89%	
European Enhanced Equity	100%	
CMIG Access 80%	100%	
Continental Euro Equity	97.56%	
UK Equity	73.76%	
US Enhanced Equity	87.67%	
Japan Enhanced Equity	93.57%	
Pacific Enhanced Basin	78.82%	
Euro Bond	69.14%	
US Bond	93.52%	
US Currency Reserve	76.15%	
Euro Currency Reserve	98.70%	
CMIG Focus Euro Bond	99.96%	
INVESTMENT PORTFOLIO ICVC		2
IPS Growth	22.01%	
THE TM LEVITAS FUNDS		18
TM Levitas A Fund	21.56%	
TM Levitas B Fund	26.39%	
UBS INVESTMENT FUNDS ICVC		15
UBS Global Optimal Fund	25.42%	
UBS UK Opportunities Fund	44.79%	

Principal place of business for collective investment vehicles

(1)	Trinity Road, Halifax West Yorkshire, HX1 2RG
(2)	15 Dalkeith Road, Edinburgh EH16 5WL
(3)	39/40 Upper Mount Street, Dublin, Ireland
(4)	20 Churchill Place, Canary Wharf, London E14 5HJ
(5)	80 route d'Esch, L-1470 Luxembourg
(6)	Lemanik Asset Management S.A 106 route d'Arlon, L-8210 Mamer Luxembourg
(7)	35a avenue John F. Kennedy, L-1855, Luxembourg
(8)	ABERDEEN ASSET MANAGERS LTD, 1 BREAD STREET, BOW BELLS HOUSE, LONDON EC4M 9HH
(9)	BlackRock Fund Managers Limited, 12 Throgmorton Avenue, London EC2N 2DL
(10)	BNY MELLON INVESTMENT FUNDS, BNY MELLON CENTRE, 160 QUEEN VICTORIA STREET, LONDON EC4V 4LA
(11)	INSIGHT INVESTMENT MGMT GLOBAL, 160 QUEEN VICTORIA STREET, LONDON EC4V 4LA
(12)	Perpetual Park, Perpetual Park Drive, Henley-on-Thames, Oxfordshire, RG9 1HH
(13)	78 SIR JOHN ROGERSON'S QUAY, DUBLIN 2, IRELAND
(14)	SCHRODER UNIT TRUSTS LIMITED, 31 GRESHAM STREET, LONDON, EC2V 7QA
(15)	UBS INVESTMENT FUNDS ICVC, 21 LOMBARD STREET, LONDON, EC3V 9AH
(16)	Oppenheim Asset Management Services S.à r.l. , 2, Boulevard Konrad Adenauer, L-1115 Luxemburg
(17)	LDI Solutions Plus plc, 32 Molesworth Street, Dublin 2, Ireland
(18)	Thesis Unit Trust Management Limited, Exchange Building, St. John's Street, Chichester, West Sussex PO19 1UP

Subsidiaries and related undertakings

Registered office addresses

(1)	25 Gresham Street, London, EC2V 7HN
(2)	Charterhall House, Charterhall Drive, Chester, CH88 3AN
(3)	Port Hamilton, 69 Morrison Street, Edinburgh, EH3 8YF
(4)	Trinity Road, Halifax, HX1 2RG
(5)	The Mound, Edinburgh, EH1 1YZ
(6)	25 New Street, St. Helier, Jersey, JE4 8RG
(7)	116 Cockfosters Road, Barnet, Hertfordshire, EN4 0DY
(8)	Minter Ellison, Governor Macquire Tower, Level 40, 1 Farrer Place, Sydney, NSW 2000, Australia
(9)	1 Brookhill Way, Banbury, Oxon, OX16 3EL
(10)	Sanne Group, 13 Castle Street, St. Helier, Jersey, JE4 5UT
(11)	26th Floor, Oxford House, Taikoo Place, Quarry Bay, Hong Kong
(12)	Barnett Way, Gloucester, GL4 3RL
(13)	1 More London Place, London, SE1 2AF
(14)	1095 Avenue of the America's, 34th Floor, New York, NY 10036, United States
(15)	2nd Floor, 14 Cromac Place, Gasworks, Belfast, BT7 2JB
(16)	Rineanna House, Shannon Free Zone, Co. Clare, Ireland
(17)	Level 1, Citymark, 150 Fountainbridge, Edinburgh, EH3 9PE
(18)	Cox and Palmer, Suite 400, 371 Queen Street, Phoenix Square, Fredericton, NB E3B 4Y9, Canada
(19)	6 Rue Jean Monnet, L-2180 Luxembourg,
(20)	33 Old Broad Street, London, EC2N 1HZ
(21)	Prins Bernhardplein 200, 1097 JB, Amsterdam, Netherlands
(22)	Citco REIF Services, 20 Rue de Poste, L-2346, Luxembourg
(23)	RL360 House, Cooil Road, Douglas, Isle of Man, IM2 2SP
(24)	Centre Orchimont, 36 Rangwee, L-2412, Luxembourg
(25)	Corporation Service Company, Suite 400, 2711 Centre Road, Wilmington, DE 19805, United States
(26)	4th Floor, 4 Victoria Square, St Albans, AL1 3TF, United Kingdom
(27)	1 Allee Scheffer, Luxembourg, L-2520, Luxembourg
(28)	SAB Formalities, 23 Rue de Roule, Paris, 75001, France
(29)	Rockspring, 166 Sloane Street, London, SW1X 9QF
(30)	Tronador 4890, 9th Floor, Buenos Aires, 1430, Argentina
(31)	138 Market Street, #27-01/02, Capita Green, 048946, Singapore
(32)	McStay Luby, Dargan House, 21-23 Fenian Street, Dublin 2, Ireland
(33)	124-127 St. Stephen's Green, Dublin 2, Ireland
(34)	21 St. Thomas Street, Bristol, BS1 6JS
(35)	De Entrée 254, 1101 EE, Amsterdam, Netherlands
(36)	47 Esplanade, St. Helier, Jersey, JE1 0BD
(37)	Sarnia House, Le Truchot, St. Peter Port, Guernsey, GY1 4EF
(38)	1 Rodney Square, 10th Floor, Tenth and King Street, Wilmington, DE 19801, United States
(39)	Royal Ocean Plaza, Ocean Village, GX11 1AA, Gibraltar
(40)	110 St. Vincent Street, Glasgow, G2 4QR
(41)	35 Great St. Helen's, London, EC3A 6AP
(42)	Charlton Place, Charlton Road, Andover, SP10 1RE
(43)	22 Grenville Street, St. Helier ,Jersey, JE4 8PX
(44)	Queensway House, Hilgrove Street, St. Helier, Jersey, JE4 1ES
(45)	6/12, Primrose Road, , Bangalore , 560025, India (49) Av. Jurubatuba 73, 8th Floor, Sao Paulo, Brazil
(46)	Avenida Jurubatuba 73, 8° Andar, Vila Cordeiro, São Paulo, SP, CEP 04583-100, Brazil
(47)	Corporation Trust Centre, 1209 Orange Street, Wilmington, DE 19801, United States
(48)	18th Floor, United Centre, 95 Queensway, Hong Kong
(49)	Finance House, Orchard Brae, Edinburgh, EH4 1PF
(50)	55 Baker Street, London, W1U 7EU
(51)	15 Dalkeith Road, Edinburgh, EH16 5BU
(52)	Lichtenauerlann 170, 3062ME, Rotterdam, Netherlands
(53)	Weena 340, 3012 NJ, Rotterdam, Netherlands
(54)	Caledonian Exchange, 19A Canning Street, Edinburgh, EH3 8HE
(55)	44 Chipman Hill, Suite 1000, St. John, NB E2L 2A9, Canada
(56)	155 Bishopsgate, London, EC2M 3YB
(57)	P O Box 12, Peveril Buildings, Peveril Square, Douglas, Isle of Man, IM99 1JJ
(58)	44 Esplanade, St. Helier, Jersey, JE4 9WG
(59)	Asticus Building 2nd Floor, 21 Palmer Street, London, SW1H 0AD
(60)	26 New Street St Helier Jersey JE2 3RA
(61)	Fred. Roeskestraat 123, 1076 EE, Amsterdam, Netherlands
(62)	Avenue Louise 331-333, 1050 Brussels, Belgium
(63)	Naritaweg 165, 1043 BW, Amsterdam, Netherlands
(64)	Calle Pinar 7, 5Olzquierda, 28006, Madrid, Spain
(65)	2nd Floor Beaux Lane House, Mercer Street Lower, Dublin 2, Ireland
(66)	Wilmington Trust SP Services (London) Limited, Third Floor, 1 King's Arms Yard, London, EC2R 7AF
(67)	40a Station Road, Upminster, Essex, RM14 2TR
(68)	1 Grant's Row, Lower Mount Street, Dublin 2, Ireland
(69)	Black Horse House, Bentalls, Basildon, Essex, SS14 3BY
(70)	Maples and Calder, P.O. Box 309, Ugland House, South Church Street, George Town, Grand Cayman, KY1-1104, Cayman Islands
(71)	106 Goring Road, Goring By Sea, Worthing, West Sussex, BN12 4AA
(72)	8 Avenue Hoche, 75008, Paris, France
(73)	10 George Street, Edinburgh, EH2 2DZ
(74)	Pentagon House, 52-54 Southwark Street, London, SE1 1UN
(75)	Riverside House, 502 Gorgie Road, Edinburgh, EH11 3AF
(76)	St William House, Tresillian Terrace, Cardiff, CF10 5BH
(77)	Drake House, Gadbrook Park, Rudheath, Northwich, CW9 7TW, United Kingdom
(78)	Tower House, Charterhall Drive, Chester, CH88 3AN
(79)	Stansfield House, Chester Business Park, Chester, CH4 9QQ, United Kingdom
(80)	Glategny Court, Glategny Esplanade, St Peter Port, GY1 3HQ, Guernsey
(81)	The Residency, 7th Floor, 133/1 Residency Road, Bangalore, 560025, India
(82)	1A Heienhaff, Senningerberg, L-1736, Luxembourg
(83)	30 Finsbury Square, London, EC2P 2YU, United Kingdom
(84)	Fifth Floor, 100 Wood Street, London, EC2V 7EX, United Kingdom
(85)	EY Atria One, 144 Morrison Street, Edinburgh, EH3 8EB
(86)	PO BOX 12757, 67 Morrison Street, Edinburgh, Lothian, EH3 8YJ
(87)	Sitz, Niederlassung, Inländische Geschäftsanschrift, Empfangsberechtigte Person, Zweigniederlassungen, Berlin
(88)	20 Rue de la Poste, L-2346 Luxembourg
(89)	106 Route d'Arlon, Mamer, L-8210, Luxembourg

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