

Lloyds Bank plc

Half-Year Management Report

For the half-year to 30 June 2017

Member of the Lloyds Banking Group

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements with respect to the business, strategy and plans of 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 Lloyds Bank Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such 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 (including low or negative rates), 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; the ability to attract and retain senior management and other employees; 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. Except as required by any applicable law or regulation, the forward looking statements contained in this document are made as of today's date, and Lloyds Bank Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

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FINANCIAL REVIEW

Principal activities

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

Review of results

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 within the next 12 months. 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 half-year to 30 June 2017, the Group recorded a profit before tax from its continuing operations of £2,579 million compared with a profit before tax in the half-year to 30 June 2016 of £905 million. The results have been affected by a number of one-off items. In the half-year to 30 June 2016 the Group had incurred a loss of £993 million 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. In the half-year to 30 June the Group has incurred conduct charges of £1,211 million compared to £460 million in the half year to 30 June 2016. Excluding these items from both periods, the Group recorded a profit before tax of £3,790 million in the half-year to 30 June 2017, an increase of £463 million, or 14 per cent, from £3,384 million in the half-year to 30 June 2016.

Total income increased by £2,269 million, or 35 per cent, to £8,730 million in the half-year to 30 June 2017 compared with £6,461 million in the half-year to 30 June 2016, comprising a £1,791 million increase in other income and a £478 million increase in net interest income.

Net interest income was £5,941 million in the half-year to 30 June 2017; an increase of £478 million compared to £5,463 million in the half-year to 30 June 2016. Average interest-earning assets fell but the net interest margin improved driven by lower deposit and wholesale funding costs which have more than offset reduced lending rates.

Other income was £1,791 million higher at £2,789 million in the half-year to 30 June 2017 compared to £998 million in the half-year to 30 June 2016. Net fee and commission income was £5 million or 1 per cent, lower at £941 million compared to £946 million in the half-year to 30 June 2016. Net trading income increased by £143 million, or 30 per cent, to £615 million in the half-year to 30 June 2017 compared to £472 million in the half-year to 30 June 2016. Other operating income was £1,653 million higher at £1,233 million in the half-year to 30 June 2017 compared to a deficit of £420 million in the half-year to 30 June 2016. Other operating income in the half-year to 30 June 2016 included the losses on capital transactions totalling £2,019 million detailed above but this impact is partly offset by a £258 million reduction in gains on sale of available-for-sale financial assets. Losses of £15 million on liability management actions in the half-year to 30 June 2017 compared to gains of £147 million in the half-year to 30 June 2016.

FINANCIAL REVIEW (continued)

Operating expenses increased by £754 million, or 15 per cent to £5,948 million in the half-year to 30 June 2017 compared with £5,194 million in the half-year to 30 June 2016. A provision of £1,211 million was made in respect of conduct issues in the half-year to 30 June 2017 compared to a charge of £403 million in the same period in 2016. The charge in 2017 includes £700 million in respect of PPI, reflecting current claim levels, which remain above the Group's previous provision assumption; the additional provision will now cover claims of around 9,000 per week through to the end of August 2019. Other conduct provisions of £511 million cover a number of items including packaged bank accounts and arrears handling. 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 the Group is reimbursing mortgage arrears fees. The Group is also currently undertaking a review of the HBOS Reading fraud and is in the process of paying compensation to the victims of the fraud for economic losses, ex-gratia payments and awards for distress and inconvenience. A provision of £100 million was taken and reflects the estimated compensation costs for HBOS Reading.

Excluding all conduct charges from both years, operating expenses were £54 million, or 1 per cent, lower at £4,737 million in the half-year to 30 June 2017 compared to £4,791 million in the half-year to 30 June 2016. Staff costs were £114 million, or 5 per cent, lower at £2,258 million in the half-year to 30 June 2017 compared with £2,372 million in the half-year to 30 June 2016; annual pay rises have been offset by the impact of headcount reductions resulting from the Group's rationalisation programmes and there has been a reduction in severance costs. Premises and equipment costs were £49 million or 14 per cent, higher at £388 million in the half-year to 30 June 2017 compared with £339 million in the half-year to 30 June 2016, in part due to lower profits on sale of tangible assets. Other expenses were £44 million, or 5 per cent, higher at £1,000 million in the half-year to 30 June 2017 compared to £956 million in the half-year to 30 June 2016. Depreciation and amortisation costs were £33 million, or 3 per cent, lower at £1,091 million in the half-year to 30 June 2017 compared to £1,124 million in the half-year to 30 June 2016, as higher depreciation on operating lease assets due to increased balances has been offset by reduced charges on intangible assets following certain intangibles related to the acquisition of HBOS in 2009 becoming fully amortised.

Impairment losses decreased by £159 million, or 44 per cent, to £203 million in the half-year to 30 June 2017 compared with £362 million in the half-year to 30 June 2016. Impairment losses in respect of loans and advances to customers were £29 million, or 13 per cent, lower at £200 million in the half-year to 30 June 2017 compared with £229 million in the half-year to 30 June 2016; this reflects continuing benign economic conditions and the Group's conservative approach to risk. There was a charge of £6 million in the half-year to 30 June 2017, compared to £146 million in the half-year to 30 June 2016, in respect of the impairment of available-for-sale financial assets;

In the half-year to 30 June 2017, the Group recorded a tax charge of £858 million compared to a charge of £241 million in the half-year to 30 June 2016, an effective tax rate of 33 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 half-year to 30 June 2017, the Group recorded a profit before tax from discontinued operations of £389 million compared with a profit before tax in the half-year to 30 June 2016 of £98 million.

Total income decreased by £1,901 million, or 18 per cent, to £8,852 million in the half-year to 30 June 2017 compared with £10,753 million in the half-year to 30 June 2016, comprising a £1,706 million decrease in other income and a £195 million decrease in net interest income.

Net interest income was an expense of £676 million in the half-year to 30 June 2017; a decrease of £195 million compared to an expense of £481 million in the half-year to 30 June 2016. There was an increase of £221 million in the half-year to 30 June 2017 in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group, reflecting improved levels of investment returns on the assets held by the OEICs. After adjusting for these amounts payable to unitholders, net interest income was £26 million higher.

FINANCIAL REVIEW (continued)

Other income was £1,706 million lower at £9,528 million in the half-year to 30 June 2017 compared to £11,234 million in the half-year to 30 June 2016. Net fee and commission income was £32 million or 3 per cent, improved at a deficit of £93 million compared to a deficit of £125 million in the half-year to 30 June 2016. Net trading income decreased by £1,574 million, or 23 per cent, to £5,223 million in the half-year to 30 June 2017 compared to £6,797 million in the half-year to 30 June 2016; with reduced gains on debt securities, partly following the disposal of high-yielding bonds, more than offsetting increased equity income in line with market performance. Insurance premium income was £113 million, or 3 per cent, lower at £4,099 million in the half-year to 30 June 2017 compared with £4,212 million in the same period in 2016; there was a decrease of £55 million in life insurance premiums and a decrease of £58 million in general insurance premiums following the run-down of closed products. Other operating income was £51 million lower at £299 million in the half-year to 30 June 2017 compared to £350 million in the half-year to 30 June 2016.

Insurance claims expense was £2,134 million lower at £7,976 million in the half-year to 30 June 2017 compared to £10,110 million in the half-year to 30 June 2016. The insurance claims expense in respect of life and pensions business was £2,118 million lower at £7,805 million in the half-year to 30 June 2017 compared to £9,923 million in the half-year to 30 June 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 £16 million or 9 per cent, lower at £171 million in the half-year to 30 June 2017 compared to £187 million in the same period in 2016.

Operating expenses decreased by £58 million, or 11 per cent to £487 million in the half-year to 30 June 2017 compared with £545 million in the half-year to 30 June 2016.

Balance sheet and capital

Total assets were £2,479 million lower at £828,448 million at 30 June 2017 compared to £830,927 million at 31 December 2016. Cash and balances at central banks were £3,039 million, or 6 per cent, higher at £50,491 million at 30 June 2017 compared to £47,452 million at 31 December 2016 as the Group takes advantage of opportunities for the placing of surplus funds. Loans and advances to customers were £6,534 million, or 1 per cent, higher at £457,816 million at 30 June 2017 compared to £451,282 million at 31 December 2016; a £3,106 million increase in reverse repurchase agreement balances together with the addition of £7,878 million of lending in MBNA, 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.

Total liabilities were £2,545 million lower at £778,131 million at 30 June 2017 compared to £780,676 million at 31 December 2016. Deposits from banks were £8,251 million, or 53 per cent, higher at £23,941 million at 30 June 2017 compared to £15,690 million at 31 December 2016 as a result of the use of repurchase agreements as a favourable form of funding. Customer deposits were £2,157 million higher at £417,617 million compared to £415,460 million at 31 December 2016 as a £1,499 million reduction in repurchase agreement balances and reductions in non-relationship deposit balances were more than offset by strong inflows from Commercial clients. Debt securities in issue were £8,363 million, or 11 per cent, lower at £66,370 million at 30 June 2017 compared to £74,733 million at 31 December 2016 following maturities of some tranches of securitisation notes and covered bonds.

Total equity was £66 million higher at £50,317 million at 30 June 2017 compared to £50,251 million at 31 December 2016 as the profit for the period has been offset by negative movements in the Group's cash flow hedging reserve and dividends paid.

FINANCIAL REVIEW (continued)

The Group's common equity tier 1 capital ratio remained at 15.1 per cent, reflecting a combination of profit generation, the receipt of the dividend paid by the Insurance business in February 2017 and a reduction in the deferred tax asset deducted from capital, offset by the accrual for foreseeable dividends in respect of the first half of 2017, movements in the defined benefit pension schemes, an increase in the deduction for goodwill and other intangible assets following the acquisition of MBNA and an increase in risk-weighted assets. The tier 1 capital ratio reduced to 17.5 per cent (31 December 2016: 17.7 per cent) primarily reflecting the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments and the increase in risk-weighted assets, largely offset by the increase in common equity tier 1 capital. The total capital ratio reduced to 20.9 per cent (31 December 2016: 21.2 per cent), largely reflecting amortisation and foreign exchange movements on tier 2 instruments and the overall increase in risk-weighted assets partly offset by the transitioning of grandfathered AT1 instruments to tier 2.

Risk-weighted assets increased by £2,420 million, or 1 per cent, to £218,603 million at 30 June 2017, compared to £216,183 million at 31 December 2016, largely reflecting the acquisition of MBNA and targeted growth in key customer segments, partly offset through active portfolio management, disposals and other movements.

FINANCIAL REVIEW (continued)**Capital ratios**

	At 30 June 2017 £m	At 31 Dec 2016 £m
Capital resources (transitional)		
Common equity tier 1		
Shareholders' equity per balance sheet	46,317	46,289
Adjustment to retained earnings for foreseeable dividends	(1,080)	(1,568)
Deconsolidation adjustments ¹	1,095	911
Adjustment for own credit	119	87
Cash flow hedging reserve	(1,839)	(2,224)
Other adjustments	(40)	(90)
	<u>44,572</u>	<u>43,405</u>
Less: deductions from common equity tier 1		
Goodwill and other intangible assets	(2,651)	(1,623)
Prudent valuation adjustment	(636)	(630)
Excess of expected losses over impairment provisions and value adjustments	(551)	(602)
Removal of defined benefit pension surplus	(320)	(267)
Securitisation deductions	(198)	(217)
Significant investments ¹	(3,946)	(3,986)
Deferred tax assets	(3,286)	(3,536)
Common equity tier 1 capital	<u>32,984</u>	<u>32,544</u>
Additional tier 1		
Additional tier 1 instruments	6,583	7,061
Less: deductions from tier 1		
Significant investments ¹	(1,262)	(1,329)
Total tier 1 capital	<u>38,305</u>	<u>38,276</u>
Tier 2		
Tier 2 instruments	8,445	8,920
Eligible provisions	255	186
Less: deductions from tier 2		
Significant investments ¹	(1,371)	(1,571)
Total tier 2 capital	<u>7,329</u>	<u>7,535</u>
Total capital resources	<u>45,634</u>	<u>45,811</u>
Risk-weighted assets	218,603	216,183
Common equity tier 1 capital ratio	15.1%	15.1%
Tier 1 capital ratio	17.5%	17.7%
Total capital ratio	20.9%	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.

FINANCIAL REVIEW (continued)

	At 30 June 2017 £m	At 31 Dec 2016 £m
Risk-weighted assets		
Foundation Internal Ratings Based (IRB) Approach	61,115	64,907
Retail IRB Approach	65,331	64,970
Other IRB Approach	18,360	17,788
IRB Approach	144,806	147,665
Standardised Approach	24,794	18,956
Credit risk	169,600	166,621
Counterparty credit risk	7,188	8,419
Contributions to the default fund of a central counterparty	419	340
Credit valuation adjustment risk	735	864
Operational risk	26,222	25,292
Market risk	2,930	3,147
Underlying risk-weighted assets	207,094	204,683
Threshold risk-weighted assets	11,509	11,500
Transitional risk-weighted assets	218,603	216,183

PRINCIPAL RISKS AND UNCERTAINTIES

The most significant risks faced by the Group which could impact the success of delivering against the Group's long-term strategic objectives and through which global macro-economic, regulatory developments and market liquidity dynamics could manifest, are detailed below. Except where noted, there has been no significant change to the description of these risks or key mitigating actions disclosed in the Group's 2016 Annual Report and Accounts, with any quantitative disclosures updated herein.

Credit risk – The risk that customers and/or other counterparties whom the Group has either lent money to or entered into a financial contract with, or other counterparties with whom the Group has contracted, fail to meet their financial obligations, resulting in loss to the Group. Adverse changes in the economic and market environment the Group operates in or the credit quality and/or behaviour of the Group's customers and counterparties could reduce the value of the Group's assets and potentially increase the Group's write downs and allowances for impairment losses, adversely impacting profitability.

Conduct risk – Conduct risk can arise from the failure to design products and services to ensure they are aligned to customer needs and to design and execute sales processes to ensure products and services are offered only to those customers who need and will benefit from them. Additionally, the failure to provide ongoing support and service to customers and to recognise and respond to customer complaints, providing appropriate rectification in a timely manner. Conduct risk can result from the failure to ensure that colleagues behave in line with conduct, regulatory and ethical standards. Additionally, market conduct risks exist where actions taken can disrupt the fair and effective operation of a market in which the Group is active.

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

Operational risk – The Group faces significant operational risks, such as risk of cyber and terrorism, which may result in financial loss, disruption of services to customers, and damage to its reputation. These include the availability, resilience and security of the Group's core IT systems and the potential for failings in the Group's customer processes.

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

Funding and liquidity risk – 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.

Regulatory and legal risk – The risks of changing legislation, regulation (including regulatory changes such as the Second Payment Services Directive and Open Banking), policies, voluntary codes of practice and their interpretation in the markets in which the Group operates can have a significant impact on the Group's operations, business prospects, structure, costs and/or capital requirements and ability to enforce contractual obligations.

Governance risk – Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from the requirement to improve the resolvability of the Group and to ring-fence core UK financial services and activities from January 2019, and from the further development of the Senior Managers and Certification Regime.

People risk – Key people risks include the risk that the Group fails to maintain organisational skills, capability, resilience and capacity levels in response to increasing volumes of organisational, political and external market change.

Insurance risk – Key insurance risks within the Insurance business are longevity, persistency and property insurance. Longevity risk is expected to increase as the Group's presence in the bulk annuity market increases. Longevity is also the key insurance risk in the Group's Defined Benefit Pension Schemes.

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED INCOME STATEMENT

	Note	Half-year to 30 June 2017 £ million	Half-year to 30 June 2016 £ million
Interest and similar income		7,778	8,471
Interest and similar expense		(1,837)	(3,008)
Net interest income		5,941	5,463
Fee and commission income		1,428	1,420
Fee and commission expense		(487)	(474)
Net fee and commission income		941	946
Net trading income		615	472
Other operating income		1,233	(420)
Other income		2,789	998
Total income		8,730	6,461
Regulatory provisions		(1,211)	(403)
Other operating expenses		(4,737)	(4,791)
Total operating expenses	3	(5,948)	(5,194)
Trading surplus		2,782	1,267
Impairment	4	(203)	(362)
Profit before tax – continuing operations		2,579	905
Taxation	5	(858)	(241)
Profit after tax – continuing operations		1,721	664
Profit after tax – discontinued operations	9	331	86
Profit for the period		2,052	750
Profit attributable to ordinary shareholders		1,864	686
Profit attributable to other equity shareholders ¹		137	1
Profit attributable to equity holders		2,001	687
Profit attributable to non-controlling interests		51	63
Profit for the period		2,052	750

¹ The profit after tax attributable to other equity holders of £137 million (half-year to 30 June 2016: £1 million) is offset in reserves by a tax credit attributable to ordinary shareholders of £37 million (half-year to 30 June 2016: £nil).

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Half-year to 30 June 2017 £ million	Half-year to 30 June 2016 £ million
Profit for the period	2,052	750
Other comprehensive income:		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before taxation	(124)	(267)
Taxation	32	40
	(92)	(227)
Gains and losses attributable to own credit risk		
Gains and (losses) before taxation	(44)	-
Taxation	12	-
	(32)	-
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	455	184
Income statement transfers in respect of disposals	(315)	(574)
Income statement transfers in respect of impairment	6	146
Taxation	(48)	152
	98	(92)
Movement in cash flow hedging reserve:		
Effective portion of changes in fair value	(212)	2,968
Net income statement transfers	(313)	(223)
Taxation	140	(735)
	(385)	2,010
Currency translation differences (tax: nil)	(7)	(20)
Other comprehensive income for the period, net of tax	(418)	1,671
Total comprehensive income for the period	1,634	2,421
Total comprehensive income attributable to ordinary shareholders arising from continuing operations	1,103	2,454
Total comprehensive income attributable to ordinary shareholders arising from discontinued operations	343	(97)
Total comprehensive income attributable to ordinary shareholders	1,446	2,357
Total comprehensive income attributable to other equity holders	137	1
Total comprehensive income attributable to equity holders	1,583	2,358
Total comprehensive income attributable to non-controlling interests	51	63
Total comprehensive income for the period	1,634	2,421

CONSOLIDATED BALANCE SHEET

	Note	At 30 June 2017 £ million	At 31 Dec 2016 £ million
Assets			
Cash and balances at central banks		50,491	47,452
Items in course of collection from banks		855	706
Trading and other financial assets at fair value through profit or loss	6	48,946	51,198
Derivative financial instruments		28,332	33,859
Loans and receivables:			
Loans and advances to banks		6,274	5,583
Loans and advances to customers	7	457,816	451,282
Debt securities		3,841	3,397
Due from fellow Lloyds Banking Group undertakings		6,760	5,624
		474,691	465,886
Available-for-sale financial assets		51,803	56,524
Goodwill		463	180
Other intangible assets		2,380	1,520
Property, plant and equipment		9,468	9,294
Current tax recoverable		46	28
Deferred tax assets		3,316	3,603
Retirement benefit assets	11	406	342
Assets of held-for-sale disposal group	9	152,269	158,194
Other assets		4,982	2,141
Total assets		828,448	830,927

CONSOLIDATED BALANCE SHEET (continued)

		At 30 June 2017 £ million	At 31 Dec 2016 £ million
Equity and liabilities			
Liabilities			
Deposits from banks		23,941	15,690
Customer deposits		417,617	415,460
Due to fellow Lloyds Banking Group undertakings		9,967	5,444
Items in course of transmission to banks		944	548
Trading and other financial liabilities at fair value through profit or loss		55,671	54,504
Derivative financial instruments		27,949	33,896
Notes in circulation		1,317	1,402
Debt securities in issue	10	66,370	74,733
Liabilities of held-for-sale disposal group	9	144,931	150,938
Other liabilities		6,065	4,732
Retirement benefit obligations	11	782	692
Current tax liabilities		1,036	446
Other provisions		6,018	4,933
Subordinated liabilities		15,523	17,258
Total liabilities		778,131	780,676
Equity			
Share capital		1,574	1,574
Share premium account		600	-
Other reserves		8,190	8,484
Retained profits		35,953	36,231
Shareholders' equity		46,317	46,289
Other equity instruments		3,217	3,217
Total equity excluding non-controlling interests		49,534	49,506
Non-controlling interests		783	745
Total equity		50,317	50,251
Total equity and liabilities		828,448	830,927

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders				Other equity instruments £ million	Non-controlling interests £ million	Total £ million
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million			
Balance at 1 January 2017	1,574	8,484	36,231	46,289	3,217	745	50,251
Comprehensive income							
Profit for the period	-	-	2,001	2,001	-	51	2,052
<i>Other comprehensive income</i>							
Post-retirement defined benefit scheme remeasurements, net of tax	-	-	(92)	(92)	-	-	(92)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	-	98	-	98	-	-	98
Gains and losses attributable to own credit risk, net of tax	-	-	(32)	(32)	-	-	(32)
Movements in cash flow hedging reserve, net of tax	-	(385)	-	(385)	-	-	(385)
Currency translation differences (tax: nil)	-	(7)	-	(7)	-	-	(7)
Total other comprehensive income	-	(294)	(124)	(418)	-	-	(418)
Total comprehensive income	-	(294)	1,877	1,583	-	51	1,634
Transactions with owners							
Dividends (note 16)	-	-	(1,600)	(1,600)	-	(10)	(1,610)
Distributions on other equity instruments, net of tax	-	-	(100)	(100)	-	-	(100)
Redemption of preference shares	600	-	(600)	-	-	-	-
Capital contributions received	-	-	219	219	-	-	219
Return of capital contributions	-	-	(74)	(74)	-	-	(74)
Changes in non-controlling interests	-	-	-	-	-	(3)	(3)
Total transactions with owners	600	-	(2,155)	(1,555)	-	(13)	(1,568)
Balance at 30 June 2017	2,174	8,190	35,953	46,317	3,217	783	50,317

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2016	37,107	5,987	3,868	46,962	-	391	47,353
Comprehensive income							
Profit for the period	-	-	687	687	-	63	750
<i>Other comprehensive income</i>							
Post-retirement defined benefit scheme remeasurements, net of tax	-	-	(227)	(227)	-	-	(227)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	-	(92)	-	(92)	-	-	(92)
Movements in cash flow hedging reserve, net of tax	-	2,010	-	2,010	-	-	2,010
Currency translation differences (tax: nil)	-	(20)	-	(20)	-	-	(20)
Total other comprehensive income	-	1,898	(227)	1,671	-	-	1,671
Total comprehensive income	-	1,898	460	2,358	-	63	2,421
Transactions with owners							
Dividends	-	-	(2,430)	(2,430)	-	(2)	(2,432)
Distributions on other equity instruments, net of tax	-	-	(1)	(1)	-	-	(1)
Redemption of preference shares	1,840	-	(1,840)	-	-	-	-
Capital contributions received	-	-	143	143	-	-	143
Return of capital contributions	-	-	(405)	(405)	-	-	(405)
Issue of Additional Tier 1 securities	-	-	-	-	3,217	-	3,217
Changes in non-controlling interests	-	-	-	-	-	(20)	(20)
Total transactions with owners	1,840	-	(4,533)	(2,693)	3,217	(22)	502
Balance at 30 June 2016	38,947	7,885	(205)	46,627	3,217	432	50,276

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 July 2016	38,947	7,885	(205)	46,627	3,217	432	50,276
Comprehensive income							
(Loss) profit for the period	-	-	415	415	-	38	453
<i>Other comprehensive income</i>							
Post-retirement defined benefit scheme remeasurements, net of tax	-	-	(801)	(801)	-	-	(801)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	-	1,289	-	1,289	-	-	1,289
Movements in cash flow hedging reserve, net of tax	-	(701)	-	(701)	-	-	(701)
Currency translation differences, net of tax	-	11	-	11	-	-	11
Total other comprehensive income	-	599	(801)	(202)	-	-	(202)
Total comprehensive income	-	599	(386)	213	-	38	251
Transactions with owners							
Dividends	-	-	(610)	(610)	-	(27)	(637)
Distributions on other equity instruments	-	-	(85)	(85)	-	-	(85)
Capital restructuring	(37,373)	-	37,373	-	-	-	-
Capital contribution received	-	-	180	180	-	-	180
Return of capital contributions	-	-	(36)	(36)	-	-	(36)
Other changes in non-controlling interests	-	-	-	-	-	302	302
Total transactions with owners	(37,373)	-	36,822	(551)	-	275	(276)
Balance as at 31 December 2016	1,574	8,484	36,231	46,289	3,217	745	50,251

CONSOLIDATED CASH FLOW STATEMENT

	Half-year to 30 June 2017 £ million	Half-year to 30 June 2016 £ million
Profit before tax	2,968	1,003
Adjustments for:		
Change in operating assets	(16,790)	(10,042)
Change in operating liabilities	617	33,262
Non-cash and other items	8,559	7,202
Tax received	(38)	105
Net cash provided by (used in) operating activities	(4,684)	31,530
Cash flows from investing activities		
Purchase of financial assets	(1,847)	(3,441)
Proceeds from sale and maturity of financial assets	5,276	2,729
Purchase of fixed assets	(1,960)	(1,820)
Proceeds from sale of fixed assets	763	909
Acquisition of businesses, net of cash acquired	(1,909)	(6)
Disposal of businesses, net of cash disposed	26	5
Net cash used in investing activities	349	(1,624)
Cash flows from financing activities		
Dividends paid to ordinary shareholders	(1,600)	(2,430)
Distributions on other equity instruments	(137)	(1)
Dividends paid to non-controlling interests	(10)	(2)
Return of capital contribution	(74)	(405)
Issue of Additional Tier 1 securities	-	3,217
Interest paid on subordinated liabilities	(655)	(1,262)
Proceeds from issue of subordinated liabilities	-	2,753
Repayment of subordinated liabilities	(1,236)	(12,407)
Repayments to parent company	-	(4,585)
Change in non-controlling interests	(3)	(5)
Net cash used in financing activities	(3,715)	(15,127)
Effects of exchange rate changes on cash and cash equivalents	-	15
Change in cash and cash equivalents	(8,050)	14,794
Cash and cash equivalents at beginning of period	62,908	71,953
Cash and cash equivalents at end of period	54,858	86,747

Cash and cash equivalents comprise cash and balances at central banks (excluding mandatory deposits) and amounts due from banks with a maturity of less than three months. Included within cash and cash equivalents at 30 June 2017 is £2,579 million (30 June 2016: £12,613 million; 31 December 2016: £14,477 million) held within the Group's life funds, which is not immediately available for use in the business.

CONSOLIDATED CASH FLOW STATEMENT (continued)**Discontinued operations**

The impact of the Group's discontinued operations on the above cash flow statement is as follows:

	Half-year to 30 June 2017 £ million	Half-year to 30 June 2016 £ million
Net cash provided by operating activities	(11,466)	(696)
Net cash from investing activities	224	347
Net cash used in financing activities	(655)	(657)
Change in cash and cash equivalents	<u>(11,897)</u>	<u>(1,006)</u>

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1. Accounting policies, presentation and estimates

These condensed consolidated half-year financial statements as at and for the period to 30 June 2017 have been prepared in accordance with the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard 34 (IAS 34), *Interim Financial Reporting* as adopted by the European Union and comprise the results of Lloyds Bank plc (the Bank) together with its subsidiaries (the Group). They do not include all of the information required for full annual financial statements and should be read in conjunction with the Group's consolidated financial statements as at and for the year ended 31 December 2016 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Copies of the 2016 Annual Report and Accounts are available on the Lloyds Banking Group's website and are available upon request from Investor Relations, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the condensed consolidated half-year financial statements. In reaching this assessment, the directors have considered projections for the Group's capital and funding position.

Except as noted below, the accounting policies are consistent with those applied by the Group in its 2016 Annual Report and Accounts.

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 has been to increase profit after tax and reduce other comprehensive income by £32 million in the six months to 30 June 2017; there is no impact on total liabilities or shareholders' equity. Comparatives have not been restated.

Future accounting developments

Details of those IFRS pronouncements which will be relevant to the Group but which will not be effective at 31 December 2017 and which have not been applied in preparing these condensed consolidated half-year financial statements are set out in note 17.

Critical accounting estimates and judgements

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that impact the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may include 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. There have been no significant changes in the basis upon which estimates have been determined, compared to that applied at 31 December 2016.

2. Segmental analysis

The 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. 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 process.

The segmental results and comparatives are presented on an underlying basis, the basis reviewed by the chief operating decision maker. The effects of the redemption of the Group's Enhanced Capital Notes, asset sales, volatile items, the insurance grossing adjustment, liability management, restructuring costs, conduct provisions, the amortisation of purchased intangible assets and the unwind of acquisition-related fair value adjustments are excluded in arriving at underlying profit.

The Group's activities are organised into four financial reporting segments: Retail; Commercial Banking; Consumer Finance and Insurance. There has been no change to the descriptions of these segments as provided in note 4 to the Group's financial statements for the year ended 31 December 2016.

There has been no change to the Group's segmental accounting for internal segment services or derivatives entered into by units for risk management purposes since 31 December 2016.

Half-year to 30 June 2017	Net interest income £m	Other income, net of insurance claims £m	Total income, net of insurance claims £m	Profit (loss) before tax £m	External revenue £m	Inter- segment revenue £m
Underlying basis						
Retail	3,337	477	3,814	1,598	4,177	(363)
Commercial Banking	1,425	1,100	2,525	1,437	1,703	822
Consumer Finance	1,041	755	1,796	759	2,082	(286)
Insurance	(50)	872	822	408	1,036	(214)
Other	172	144	316	290	275	41
Group	5,925	3,348	9,273	4,492	9,273	-
Reconciling items:						
Insurance grossing adjustment	(608)	660	52	-		
Market volatility and asset sales ¹	20	96	116	136		
Amortisation of purchased intangibles	-	-	-	(38)		
Restructuring costs ²	-	-	-	(321)		
Fair value unwind and other items	(135)	(7)	(142)	(135)		
Payment protection insurance provision	-	-	-	(1,050)		
Other conduct provisions	-	-	-	(540)		
Removal of impact of other entities in the Lloyds Banking Group ³	63	(3)	60	424		
Group – statutory	5,265	4,094	9,359	2,968		
Continuing operations	5,941	2,789	8,730	2,579		
Discontinued operations	(676)	1,552	876	389		
Adjustments	-	(247)	(247)	-		
Group – statutory	5,265	4,094	9,359	2,968		

¹ Comprises (i) gains on disposals of assets which are not part of normal business operations (£6 million); (ii) the net effect of banking volatility and net derivative valuation adjustments (losses of £20 million); (iii) volatility relating to the insurance business (gains of £165 million); and (iv) the results of liability management exercises (losses of £15 million).

² Comprises severance related costs relating to the Simplification programme, the costs of implementing regulatory reform and ring-fencing, the rationalisation of the non-branch property portfolio and the integration of MBNA.

³ 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. Segmental analysis (continued)

Half-year to 30 June 2016	Net interest income £m	Other income, net of insurance claims £m	Total income, net of insurance claims £m	Profit (loss) before tax £m	External revenue £m	Inter-segment revenue £m
Underlying basis						
Retail	3,296	558	3,854	1,548	4,333	(479)
Commercial Banking	1,306	982	2,288	1,236	2,137	151
Consumer Finance	994	658	1,652	690	1,942	(290)
Insurance	(80)	921	841	446	300	541
Other	266	(26)	240	241	163	77
Group	5,782	3,093	8,875	4,161	8,875	-
Reconciling items:						
Insurance grossing adjustment	(423)	519	96	-		
Enhanced Capital Notes ¹	-	(790)	(790)	(790)		
Market volatility and asset sales ²	20	252	272	128		
Amortisation of purchased intangibles	-	-	-	(168)		
Restructuring costs ³	-	-	-	(307)		
Fair value unwind	(154)	36	(118)	(110)		
Other conduct provisions	-	(15)	(15)	(460)		
Removal of impact of other entities in the Lloyds Banking Group ⁴	(243)	(1,218)	(1,461)	(1,451)		
Group – statutory	4,982	1,877	6,859	1,003		
Continuing operations	5,463	998	6,461	905		
Discontinued operations	(481)	1,124	643	98		
Adjustments	-	(245)	(245)	-		
Group – statutory	4,982	1,877	6,859	1,003		

¹ The loss relating to the ECNs was £790 million, representing the write-off of the embedded derivative and the premium paid on redemption of the remaining notes.

² Comprises (i) gains on disposals of assets which are not part of normal business operations (£335 million); (ii) the net effect of banking volatility and net derivative valuation adjustments (gain of £19 million); (iii) volatility relating to the insurance business (losses of £372 million); and (iv) the results of liability management exercises (gains of £146 million).

³ Principally comprises the severance costs related to phase II of the Simplification programme.

⁴ 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. Segmental analysis (continued)

	At 30 June 2017 £m	At 31 Dec 2016 £m
Segment external assets		
Retail	297,958	300,085
Commercial Banking	181,962	188,296
Consumer Finance	52,540	40,992
Insurance	149,287	153,936
Other	133,172	134,484
Total Group	814,919	817,793
Lloyds Bank Group statutory	828,448	830,927
Impact of other entities in the Lloyds Banking Group	(13,529)	(13,134)
Segment external assets as above	814,919	817,793
Segment customer deposits		
Retail	269,405	271,005
Commercial Banking	138,764	132,628
Consumer Finance	7,134	7,920
Other	2,314	3,907
Total Group and Lloyds Bank Group statutory	417,617	415,460
Segment external liabilities		
Retail	272,870	275,006
Commercial Banking	226,383	221,395
Consumer Finance	11,028	12,494
Insurance	142,529	146,836
Other	113,763	113,247
Total Group	766,573	768,978
Lloyds Bank Group statutory	778,131	780,676
Impact of other entities in the Lloyds Banking Group	(11,558)	(11,698)
Segment external liabilities as above	766,573	768,978

3. Operating expenses

	Half-year to 30 June 2017 £m	Half-year to 30 June 2016 £m
Administrative expenses:		
Staff costs	2,258	2,372
Premises and equipment	388	339
Other expenses	1,000	956
	3,646	3,667
Depreciation and amortisation	1,091	1,124
Total operating expenses, excluding regulatory provisions	4,737	4,791
Regulatory provisions:		
Payment protection insurance provision (note 12)	700	-
Other regulatory provisions ¹ (note 12)	511	403
	1,211	403
Total operating expenses	5,948	5,194

¹ In addition, regulatory provisions of £15 million in the half-year to 30 June 2016 were charged against income.

4. Impairment

	Half-year to 30 June 2017 £m	Half-year to 30 June 2016 £m
Impairment losses on loans and receivables:		
Loans and advances to customers	200	229
Debt securities classified as loans and receivables	(4)	-
Impairment losses on loans and receivables	196	229
Impairment of available-for-sale financial assets	6	146
Other credit risk provisions	1	(13)
Total impairment charged to the income statement	203	362

5. Taxation

In accordance with IAS 34, the Group's income tax expense for the half-year to 30 June 2017 is based on the best estimate of the weighted-average annual income tax rate expected for the full financial year. The tax effects of one-off items are not included in the weighted-average annual income tax rate, but are recognised in the relevant period.

An explanation of the relationship between tax expense and accounting profit is set out below:

	Half-year to 30 June 2017 £m	Half-year to 30 June 2016 £m
Profit before tax from continuing operations	<u>2,579</u>	<u>905</u>
Tax thereon at UK corporation tax rate of 19.25 per cent (2016: 20 per cent)	(496)	(181)
Impact of bank surcharge	(231)	(59)
Impact of changes in UK corporation tax rates	(42)	(3)
Disallowed items ¹	(199)	(110)
Non-taxable items	32	73
Overseas tax rate differences	(1)	(6)
Gains exempted	69	8
Tax losses not previously recognised	9	49
Adjustments in respect of previous periods	(3)	(4)
Effect of results in joint ventures and associates	1	-
Other items	3	(8)
Tax charge on profit from continuing operations	<u>(858)</u>	<u>(241)</u>

¹ The Finance (No.2) Act 2015 introduced restrictions on the tax deductibility of provisions for conduct charges arising on or after 8 July 2015. This has resulted in tax of £172 million (half-year to 30 June 2016: £81 million).

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

	At 30 June 2017 £m	At 31 Dec 2016 £m
Trading assets	43,632	45,824
Other financial assets at fair value through profit or loss:		
Treasury and other bills	19	20
Debt securities	4,607	4,768
Equity shares	688	586
	<u>5,314</u>	<u>5,374</u>
Total trading and other financial assets at fair value through profit or loss	<u>48,946</u>	<u>51,198</u>

7. Loans and advances to customers

	At 30 June 2017 £m	At 31 Dec 2016 £m
Agriculture, forestry and fishing	7,109	6,860
Energy and water supply	1,543	2,320
Manufacturing	7,529	7,285
Construction	4,405	4,535
Transport, distribution and hotels	12,262	13,320
Postal and communications	2,537	2,564
Property companies	28,620	29,243
Financial, business and other services	46,724	46,077
Personal:		
Mortgages	305,162	306,484
Other	28,969	20,761
Lease financing	2,403	2,628
Hire purchase	12,778	11,617
	<u>460,041</u>	<u>453,694</u>
Allowance for impairment losses on loans and advances to customers	<u>(2,225)</u>	<u>(2,412)</u>
Total loans and advances to customers	<u>457,816</u>	<u>451,282</u>

Loans and advances to customers include advances securitised under the Group's securitisation and covered bond programmes (see note 10).

8. Acquisition of MBNA

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 total fair value of the purchase consideration was £2,016 million, settled in cash.

The table below sets out the fair value of the identifiable assets and liabilities acquired. The initial accounting for the acquisition has been determined provisionally because of its complexity and the limited time available between the acquisition date and the preparation of these condensed consolidated interim financial statements.

	Book value as at 1 June 2017 £m	Provisional 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
Other intangible assets	–	702	702
Other assets	217	345	562
Total assets	7,699	1,392	9,091
Liabilities			
Deposits from banks ¹	6,431	–	6,431
Other liabilities	115	184	299
Other provisions	233	395	628
Total liabilities	6,779	579	7,358
Provisional fair value of net assets acquired	920	813	1,733
Goodwill arising on acquisition			283
Total consideration			2,016

¹ Upon acquisition, the funding of MBNA was assumed by Lloyds Bank plc.

The post-acquisition profit before tax of MBNA covering the period from 1 June 2017 to 30 June 2017, which is included in the Group statutory consolidated income statement for the half-year to 30 June 2017, is £18 million.

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 £9,059 million and the Group's consolidated profit before tax from continuing operations would have been £112 million higher at £2,691 million.

9. 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 the first half of 2018. Accordingly, the assets and liabilities of the Scottish Widows Group continue to be classified as a held-for-sale disposal group at 30 June 2017 and are shown separately on the face of the balance sheet.

The Group has not recognised any impairment relating to disposal groups classified as held-for-sale during the half-year to 30 June 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.

Income statement

The results of the discontinued operations are as follows:

	Half-year to 30 June 2017 £m	Half-year to 30 June 2016 £m
Interest and similar income	117	103
Interest and similar expense	(793)	(584)
Net interest income	(676)	(481)
Fee and commission income	210	222
Fee and commission expense	(303)	(347)
Net fee and commission income	(93)	(125)
Net trading income	5,223	6,797
Insurance premium income	4,099	4,212
Other operating income	299	350
Other income	9,528	11,234
Total income	8,852	10,753
Insurance claims	(7,976)	(10,110)
Total income, net of insurance claims	876	643
Operating expenses	(487)	(545)
Profit before tax	389	98
Taxation	(58)	(12)
Profit after tax from discontinued operations	331	86

9. Disposal group (continued)**Balance sheet**

The asset and liabilities of the disposal group are comprised as follows:

	As at 30 June 2017 £m	As at 31 Dec 2016 £m
Assets		
Trading and other financial assets at fair value through profit or loss	122,688	109,687
Derivative financial instruments	2,944	3,800
Loans and receivables:		
Loans and advances to banks	2,591	21,319
Due from fellow Lloyds Banking Group undertakings	1,797	2,015
	4,388	23,334
Goodwill	1,836	1,836
Value of in-force business	5,153	5,042
Other intangible assets	156	161
Property, plant and equipment	3,522	3,678
Other assets	11,582	10,656
Total assets of disposal group	152,269	158,194
Liabilities		
Deposits from banks	938	695
Due to fellow Lloyds Banking Group undertakings	2,358	2,386
Derivative financial instruments	2,701	3,008
Debt securities in issue	1,795	1,746
Liabilities arising from insurance contracts and participating investment contracts	101,339	94,409
Liabilities arising from non-participating investment contracts	15,652	20,112
Other liabilities	16,456	24,767
Retirement benefit obligations	123	130
Current tax liabilities	95	97
Deferred tax liabilities	905	935
Other provisions	288	285
Subordinated liabilities	2,281	2,368
Total liabilities of disposal group	144,931	150,938

Cumulative other comprehensive income relating to discontinued operations at 30 June 2017 was a deficit of £172 million (31 December 2016: a deficit of £184 million).

10. Debt securities in issue

	At 30 June 2017 £m	At 31 Dec 2016 £m
Medium-term notes issued	20,477	24,867
Covered bonds	25,937	30,521
Certificates of deposit	10,994	8,127
Securitisation notes	5,182	7,937
Commercial paper	3,780	3,281
Total debt securities in issue	<u>66,370</u>	<u>74,733</u>

The notes issued by the Group's securitisation and covered bond programmes are held by external parties and by subsidiaries of the Group.

Securitisation programmes

At 30 June 2017, external parties held £5,182 million (31 December 2016: £7,937 million) and the Group's subsidiaries held £25,167 million (31 December 2016: £25,751 million) of total securitisation notes in issue of £30,349 million (31 December 2016: £33,688 million). The notes are secured on loans and advances to customers and debt securities classified as loans and receivables amounting to £49,284 million (31 December 2016: £52,184 million), the majority of which have been sold by subsidiary companies to bankruptcy remote structured entities. The structured entities are consolidated fully and all of these loans are retained on the Group's balance sheet.

Covered bond programmes

At 30 June 2017, external parties held £25,937 million (31 December 2016: £30,521 million) and the Group's subsidiaries held £700 million (31 December 2016: £700 million) of total covered bonds in issue of £26,637 million (31 December 2016: £31,221 million). The bonds are secured on certain loans and advances to customers amounting to £33,170 million (31 December 2016: £35,968 million) that have been assigned to bankruptcy remote limited liability partnerships. These loans are retained on the Group's balance sheet.

Cash deposits of £5,065 million (31 December 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.

11. Post-retirement defined benefit schemes

The Group's post-retirement defined benefit scheme obligations are comprised as follows:

	At 30 June 2017 £m	At 31 Dec 2016 £m
Defined benefit pension schemes:		
Fair value of scheme assets	43,522	44,249
Present value of funded obligations	(43,662)	(44,363)
Net pension scheme liability	(140)	(114)
Other post-retirement schemes	(236)	(236)
Net retirement benefit liability	(376)	(350)
Recognised on the balance sheet as:		
Retirement benefit assets	406	342
Retirement benefit obligations	(782)	(692)
Net retirement benefit liability	(376)	(350)

The movement in the Group's net post-retirement defined benefit scheme liability during the period was as follows:

	£m
Liability at 1 January 2017	(350)
Income statement charge	(168)
Employer contributions	281
Remeasurement	(139)
Liability at 30 June 2017	(376)

The principal assumptions used in the valuations of the defined benefit pension scheme were as follows:

	At 30 June 2017 %	At 31 Dec 2016 %
Discount rate	2.71	2.76
Rate of inflation:		
Retail Prices Index	3.18	3.23
Consumer Price Index	2.13	2.18
Rate of salary increases	0.00	0.00
Weighted-average rate of increase for pensions in payment	2.69	2.72

12. Provisions for liabilities and charges

Payment protection insurance (excluding MBNA)

The Group increased the provision for PPI costs by a further £700 million in the half-year to 30 June 2017, bringing the total amount provided to £18,046 million.

The charge in the half-year to 30 June 2017 is largely driven by a potentially higher total volume of complaints and associated operating costs due to higher reactive complaint volumes received over the past three quarters, which have averaged approximately 9,000 per week.

At 30 June 2017 a provision of £2,642 million remained unutilised relating to complaints and associated administration costs. The provision is consistent with total expected reactive complaint volumes of 5.3 million (including complaints falling under the Plevin rules and guidance) with approximately 1.2 million still expected to be received and is equivalent to approximately 9,000 complaints per week through to August 2019. Total cash payments were £660 million during the half-year to 30 June 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 52 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 Companies and customer activity.

Key metrics and sensitivities are highlighted in the table below:

Sensitivities (exclude claims where no PPI policy was held)	Actuals to date	Anticipated future ²	Sensitivity ^{2,3}
Customer initiated complaints since origination (m) ¹	4.1	1.2	0.1 = £215m
Administrative expenses (£m)	3,350	525	1 case = £450

¹ Sensitivity includes complaint handling costs.

² Anticipated future and sensitivities are impacted by a proportion of complaints and re-complaints falling under the *Plevin* rules and guidance in light of the FCA Policy Statement PS 17/3.

³ Average redress and uphold rates remain stable.

Payment protection insurance (MBNA)

With regard to MBNA, as announced in December 2016, the Group's exposure is capped at £240 million through an indemnity received from Bank of America.

12. Provisions for liabilities and charges (continued)***Other provisions for legal actions and regulatory matters******Packaged bank accounts***

In the half-year to 30 June 2017 the Group has provided an additional £95 million in respect of complaints relating to alleged mis-selling of packaged bank accounts raising the total amount provided to £600 million. As at 30 June 2017, £182 million of the provision remained unutilised. The total amount provided 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.

Arrears handling related activities

The Group has provided an additional £155 million in the half-year to 30 June 2017 (bringing the total provision to £552 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 the Group is reimbursing mortgage arrears fees to around 590,000 customers. As at 30 June 2017, the unutilised provision was £518 million.

HBOS Reading – customer review

The Group has commenced 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 review is ongoing, the Group has provided £100 million in the half-year to 30 June 2017 and is in the process of paying compensation to the victims of the fraud for economic losses, ex-gratia payments and awards for distress and inconvenience.

Other legal actions and regulatory matters

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints and claims from customers in connection with its past conduct and, where significant, provisions are held against the costs expected to be incurred as a result of the conclusions reached. In the half-year to 30 June 2017, the Group charged an additional £161 million in respect of matters across all divisions. At 30 June 2017, the Group held unutilised provisions totalling £495 million for these other legal actions and regulatory matters.

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

Visa Inc completed its acquisition of Visa Europe on 21 June 2016. The Group's share of the sale proceeds comprised cash consideration of approximately £330 million (of which approximately £300 million was received on completion of the sale and £30 million is deferred for three years) and preferred stock, which the Group measures at fair value. The preferred stock is convertible into Class A Common Stock of Visa Inc or its equivalent upon the occurrence of certain events. 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. The lawsuits, which contain broadly similar allegations, allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act and the Commodity Exchange Act, as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims, including those in connection with USD and JPY LIBOR, have been dismissed by the US Federal Court for Southern District of New York. Appeals remain possible.

Certain Group companies are also named as defendants in UK based claims raising LIBOR manipulation allegations.

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.

13. Contingent liabilities and commitments (continued)

UK shareholder litigation

In August 2014, the Lloyds Banking Group and a number of former directors were named as defendants in a claim filed in the English High Court by a number of claimants who held shares in Lloyds TSB 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. It is currently not possible to determine the ultimate impact on the Lloyds Banking Group (if any), but the Lloyds Banking Group intends to defend the claim vigorously.

Financial Services Compensation Scheme

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 these loans 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.

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 the Group's current tax liabilities of approximately £550 million and a reduction in the Group's deferred tax asset of approximately £350 million. The Lloyds Banking Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due. There are a number of other open matters on which the 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 reposessions

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 recently 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 next year.

Update following the Financial Conduct Authority's publication of Policy Statement 17/3

On 2 August 2016, the Financial Conduct Authority (FCA) published a further consultation paper (CP16/20: Rules and guidance on payment protection insurance complaints: feedback on CP15/39 and further consultation), following on from the original consultation published in November 2015.

On 2 March 2017 the FCA confirmed that the deadline by which consumers would need to make their PPI complaints would be 29 August 2019, and new rules with respect to the UK Supreme Court's decision in *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61 would come into force on 29 August 2017.

13. Contingent liabilities and commitments (continued)

On 31 May 2017 an application for judicial review of Policy Statement 17/3 was filed in the High Court of England and Wales, which subject to the Court's determination may have an impact on the implementation of the FCA's rules and guidance in Policy Statement 17/3.

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

	At 30 June 2017 £m	At 31 Dec 2016 £m
Contingent liabilities		
Acceptances and endorsements	29	21
Other:		
Other items serving as direct credit substitutes	600	779
Performance bonds and other transaction-related contingencies	2,227	2,237
	2,827	3,016
Total contingent liabilities	2,856	3,037
Commitments		
Documentary credits and other short-term trade-related transactions	1	-
Forward asset purchases and forward deposits placed	365	648
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	12,014	10,749
Other commitments	84,432	62,697
	96,446	73,446
1 year or over original maturity	36,838	40,074
Total commitments	133,650	114,168

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £61,921 million (31 December 2016: £63,203 million) was irrevocable.

14. Fair values of financial assets and liabilities

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine those fair values. Note 48 to the Group's 2016 financial statements describes the definitions of the three levels in the fair value hierarchy.

Valuation control framework

Key elements of the valuation control framework, which covers processes for all levels in the fair value hierarchy including level 3 portfolios, include model validation (incorporating pre-trade and post-trade testing), product implementation review and independent price verification. Formal committees meet quarterly to discuss and approve valuations in more judgemental areas.

Transfers into and out of level 3 portfolios

Transfers out of level 3 portfolios arise when inputs that could have a significant impact on the instrument's valuation become market observable; conversely, transfers into the portfolios arise when consistent sources of data cease to be available.

Valuation methodology

For level 2 and level 3 portfolios, there is no significant change to what was disclosed in the Group's 2016 Annual Report and Accounts in respect of the valuation methodology (techniques and inputs) applied to such portfolios.

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

	30 June 2017		31 December 2016	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	48,946	48,946	51,198	51,198
Derivative financial instruments	28,332	28,332	33,859	33,859
Loans and receivables:				
Loans and advances to banks	6,274	6,261	5,583	5,553
Loans and advances to customers	457,816	457,938	451,282	451,117
Debt securities	3,841	3,774	3,397	3,303
Due from fellow Lloyds Banking Group undertakings	6,760	6,760	5,624	5,624
	474,691	474,733	465,886	465,597
Available-for-sale financial instruments	51,803	51,803	56,524	56,524
Financial liabilities				
Deposits from banks	23,941	23,917	15,690	15,679
Customer deposits	417,617	418,050	415,460	416,490
Due to fellow Lloyds Banking Group undertakings	9,967	9,967	5,444	5,444
Trading and other financial liabilities at fair value through profit or loss	55,671	55,671	54,504	54,504
Derivative financial instruments	27,949	27,949	33,896	33,896
Debt securities in issue	66,370	69,333	74,733	77,198
Subordinated liabilities	15,523	18,149	17,258	19,280

14. Fair values of financial assets and liabilities (continued)

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

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 following tables provide an analysis of the financial assets and liabilities of the Group that are carried at fair value in the Group's consolidated balance sheet, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

Financial assets

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 30 June 2017				
Trading and other financial assets at fair value through profit or loss:				
Loans and advances to customers	–	28,445	–	28,445
Loans and advances to banks	–	1,446	–	1,446
Debt securities	13,358	3,412	1,578	18,348
Equity shares	6	–	682	688
Treasury and other bills	19	–	–	19
Total trading and other financial assets at fair value through profit or loss	<u>13,383</u>	<u>33,303</u>	<u>2,260</u>	<u>48,946</u>
Available-for-sale financial assets:				
Debt securities	44,717	5,865	114	50,696
Equity shares	527	34	546	1,107
Total available-for-sale financial assets	<u>45,244</u>	<u>5,899</u>	<u>660</u>	<u>51,803</u>
Derivative financial instruments	1	27,219	1,112	28,332
Total financial assets carried at fair value	<u>58,628</u>	<u>66,421</u>	<u>4,032</u>	<u>129,081</u>
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	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	<u>12,163</u>	<u>36,730</u>	<u>2,305</u>	<u>51,198</u>
Available-for-sale financial assets:				
Debt securities	48,649	6,529	133	55,311
Equity shares	435	17	761	1,213
Total available-for-sale financial assets	<u>49,084</u>	<u>6,546</u>	<u>894</u>	<u>56,524</u>
Derivative financial instruments	2	32,458	1,399	33,859
Total financial assets carried at fair value	<u>61,249</u>	<u>75,734</u>	<u>4,598</u>	<u>141,581</u>

14. Fair values of financial assets and liabilities (continued)

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 30 June 2017 – disposal group				
Trading and other financial assets at fair value through profit or loss:				
Debt securities	12,403	27,918	544	40,865
Equity shares	80,878	31	914	81,823
Total trading and other financial assets at fair value through profit or loss	<u>93,281</u>	<u>27,949</u>	<u>1,458</u>	<u>122,688</u>
Derivative financial instruments	123	2,821	–	2,944
Total financial assets carried at fair value	<u>93,404</u>	<u>30,770</u>	<u>1,458</u>	<u>125,632</u>
At 31 December 2016 – disposal group				
Trading and other financial assets at fair value through profit or loss:				
Debt securities	12,958	28,603	549	42,110
Equity shares	66,588	37	952	67,577
Total trading and other financial assets at fair value through profit or loss	<u>79,546</u>	<u>28,640</u>	<u>1,501</u>	<u>109,687</u>
Derivative financial instruments	267	3,533	–	3,800
Total financial assets carried at fair value	<u>79,813</u>	<u>32,173</u>	<u>1,501</u>	<u>113,487</u>

Financial liabilities

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 30 June 2017				
Trading and other financial liabilities at fair value through profit or loss:				
Liabilities held at fair value through profit or loss	–	8,223	–	8,223
Trading liabilities	2,375	45,073	–	47,448
Total trading and other financial liabilities at fair value through profit or loss	<u>2,375</u>	<u>53,296</u>	<u>–</u>	<u>55,671</u>
Derivative financial instruments	2	27,187	760	27,949
Total financial liabilities carried at fair value	<u>2,377</u>	<u>80,483</u>	<u>760</u>	<u>83,620</u>
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	2,417	42,662	–	45,079
Total trading and other financial liabilities at fair value through profit or loss	<u>2,417</u>	<u>52,085</u>	<u>2</u>	<u>54,504</u>
Derivative financial instruments	3	32,933	960	33,896
Total financial liabilities carried at fair value	<u>2,420</u>	<u>85,018</u>	<u>962</u>	<u>88,400</u>

Financial guarantees are recognised at fair value on initial recognition and are classified as level 3; the balance is not material.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 30 June 2017 – disposal group				
Total financial liabilities carried at fair value – derivative financial instruments	<u>358</u>	<u>2,343</u>	<u>–</u>	<u>2,701</u>
At 31 December 2016 – disposal group				
Total financial liabilities carried at fair value – derivative financial instruments	<u>355</u>	<u>2,653</u>	<u>–</u>	<u>3,008</u>

14. Fair values of financial assets and liabilities (continued)**Movements in level 3 portfolio**

The tables below analyse movements in the level 3 financial assets portfolio.

	Trading and other financial assets at fair value through profit or loss £m	Available- for-sale financial assets £m	Derivative assets £m	Total financial assets carried at fair value £m
At 1 January 2017	2,305	894	1,399	4,598
Exchange and other adjustments	(3)	(15)	18	-
Losses recognised in the income statement within other income	(42)	-	(226)	(268)
Losses recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	-	(199)	-	(199)
Purchases	263	24	5	292
Sales	(244)	(23)	(40)	(307)
Transfers into the level 3 portfolio	-	-	-	-
Transfers out of the level 3 portfolio	(19)	(21)	(44)	(84)
At 30 June 2017	2,260	660	1,112	4,032
Gains (losses) recognised in the income statement within other income relating to those assets held at 30 June 2017	185	-	(227)	(42)
	Trading and other financial assets at fair value through profit or loss £m	Available- for-sale financial assets £m	Derivative assets £m	Total financial assets carried at fair value £m
At 1 January 2016	5,116	684	924	6,724
Exchange and other adjustments	6	1	61	68
Gains recognised in the income statement within other income	317	-	547	864
Gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	-	248	-	248
Purchases	335	204	6	545
Sales	(2,031)	(494)	(35)	(2,560)
Transfers into the level 3 portfolio	187	136	45	368
Transfers out of the level 3 portfolio	(159)	-	(3)	(162)
At 30 June 2016	3,771	779	1,545	6,095
Gains recognised in the income statement within other income relating to those assets held at 30 June 2016	373	-	635	1,008

14. Fair values of financial assets and liabilities (continued)

Disposal group	Trading and other financial assets at fair value through profit or loss £m
At 1 January 2017	1,501
Exchange and other adjustments	(1)
Gains recognised in the income statement within other income	53
Purchases	40
Sales	(87)
Transfers into the level 3 portfolio	56
Transfers out of the level 3 portfolio	(104)
At 30 June 2017	1,458
Gains recognised in the income statement within other income relating to those assets held at 30 June 2017	49

The tables below analyse movements in the level 3 financial liabilities portfolio.

	Trading and other financial liabilities at fair value through profit or loss £m	Derivative liabilities £m	Total financial liabilities carried at fair value £m
At 1 January 2017	2	960	962
Exchange and other adjustments	-	14	14
Gains recognised in the income statement within other income	(2)	(207)	(209)
Additions	-	19	19
Redemptions	-	(26)	(26)
At 30 June 2017	-	760	760
Gains recognised in the income statement within other income relating to those liabilities held at 30 June 2017	-	(209)	(209)

	Trading and other financial liabilities at fair value through profit or loss £m	Derivative liabilities £m	Total financial liabilities carried at fair value £m
At 1 January 2016	1	723	724
Exchange and other adjustments	-	43	43
Losses recognised in the income statement within other income	1	606	607
Additions	-	10	10
Redemptions	-	(52)	(52)
At 30 June 2016	2	1,330	1,332
Losses recognised in the income statement within other income relating to those liabilities held at 30 June 2016	1	592	593

14. Fair values of financial assets and liabilities (continued)

The tables below set out the effects of reasonably possible alternative assumptions for categories of level 3 financial assets and financial liabilities which have an aggregated carrying value greater than £500 million.

				At 30 June 2017		
				Effect of reasonably possible alternative assumptions¹		
	Valuation technique(s)	Significant unobservable inputs	Range²	Carrying value £m	Favourable changes £m	Unfavourable changes £m
<i>Trading and other financial assets at fair value through profit or loss:</i>						
Equity and venture capital investments	Market approach	Earnings multiple	0.9/18.0	2,136	69	(69)
Other				124		
				2,260		
<i>Available for sale financial assets</i>				660	52	(52)
<i>Derivative financial assets:</i>						
Interest rate derivatives	Option pricing model	Interest rate volatility	0%/136%	1,112	11	(4)
				1,112		
Financial assets carried at fair value				4,032		
<i>Trading and other financial liabilities at fair value through profit or loss</i>						
				-	-	-
<i>Derivative financial liabilities:</i>						
Interest rate derivatives	Option pricing model	Interest rate volatility	0%/136%	760	-	-
				760		
Financial liabilities carried at fair value				760		

¹ Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

² The range represents the highest and lowest inputs used in the level 3 valuations.

14. Fair values of financial assets and liabilities (continued)

				At 31 December 2016		
				Carrying value £m	Effect of reasonably possible alternative assumptions ¹	
Valuation technique(s)	Significant unobservable inputs	Range ²	Favourable changes £m		Unfavourable changes £m	
<i>Trading and other financial assets at fair value through profit or loss:</i>						
Equity and venture capital investments	Market approach	Earnings multiple	0.9/10.0	2,163	63	(68)
Other				142		
				2,305		
<i>Available for sale financial assets</i>				894	48	(53)
<i>Derivative financial assets:</i>						
Interest rate derivatives	Option pricing model	Interest rate volatility	0%/115%	1,399	(3)	(19)
				1,399		
Financial assets carried at fair value				4,598		
<i>Trading and other financial liabilities at fair value through profit or loss</i>				2	-	-
<i>Derivative financial liabilities:</i>						
Interest rate derivatives	Option pricing model	Interest rate volatility	0%/115%	960	-	-
				960		
Financial liabilities carried at fair value				962		

¹ Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

² The range represents the highest and lowest inputs used in the level 3 valuations.

14. Fair values of financial assets and liabilities (continued)**Disposal group**

				<u>At 30 June 2017</u>		
				<u>Effect of reasonably possible alternative assumptions¹</u>		
	Valuation technique(s)	Significant unobservable inputs	Range ²	Carrying value £m	Favourable changes £m	Unfavourable changes £m
<i>Trading and other financial assets at fair value through profit or loss:</i>						
Unlisted equities and debt securities, property partnerships in the life funds	Underlying asset/net asset value (incl. property prices) ³	n/a	n/a	<u>1,458</u>	-	(84)
Financial assets carried at fair value				<u>1,458</u>		
				<u>At 31 December 2016</u>		
				<u>Effect of reasonably possible alternative assumptions¹</u>		
	Valuation technique(s)	Significant unobservable inputs	Range ²	Carrying value £m	Favourable changes £m	Unfavourable changes £m
<i>Trading and other financial assets at fair value through profit or loss:</i>						
Unlisted equities and debt securities, property partnerships in the life funds	Underlying asset/net asset value (incl. property prices) ³	n/a	n/a	<u>1,501</u>	-	(32)
Financial assets carried at fair value				<u>1,501</u>		

¹ Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

² The range represents the highest and lowest inputs used in the level 3 valuations.

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 unchanged from those described in the Group's 2016 financial statements.

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 and are unchanged from those described in the Group's 2016 financial statements.

15. Related party transactions**Balances and transactions with fellow Lloyds Banking Group undertakings**

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

	At 30 June 2017 £m	At 31 Dec 2016 £m
Assets		
Loans and receivables: Due from fellow Lloyds Banking Group undertakings	6,760	5,624
Derivative financial instruments	350	195
Trading and other financial assets at fair value through profit or loss	1,985	1,911
Liabilities		
Due to fellow Lloyds Banking Group undertakings	9,967	5,444
Derivative financial instruments	1,235	1,787
Debt securities in issue	187	818
Subordinated liabilities	3,032	3,815

During the half-year to 30 June 2017 the Group earned £26 million (half-year to 30 June 2016: £59 million) of interest income and incurred £119 million (half-year to 30 June 2016: £443 million) of interest expense on balances and transactions with Lloyds Banking Group plc and fellow Group undertakings.

Other related party transactions

Other related party transactions for the half-year to 30 June 2017 are similar in nature to those for the year ended 31 December 2016.

16. Dividends on ordinary shares

The Bank paid a dividend of £1,600 million on 11 May 2017; the Bank paid dividends of £2,430 million on 12 May 2016 and a further £610 million on 23 September 2016.

17. Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2017 and have not been applied in preparing these interim 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 9 'Financial Instruments', and IFRS 15 'Revenue from Contracts with Customers', as at 26 July 2017 these pronouncements are awaiting EU endorsement.

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 an established IFRS 9 programme to ensure a high quality implementation in compliance with the standard and additional regulatory guidance that has been issued. The programme involves Finance and Risk functions across the Group with Divisional and Group steering committees providing oversight. The key responsibilities of the programme include defining IFRS 9 methodology and accounting policy, development of Expected Credit Loss ('ECL') models, identifying and implementing data and system requirements, and establishing an appropriate operating model and governance framework.

The programme is progressing in line with delivery plans and is currently completing credit risk model development and embedding the IFRS 9 operating model into the business. All core models are expected to be operational by September 2017 and outputs will be reviewed and validated ahead of implementation.

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.

The Group has undertaken an assessment of the classification and measurement of financial assets and, whilst certain portfolios will need to be reclassified, including from amortised cost to fair value through profit or loss, the overall impact on the Group is not expected to be significant.

IFRS 9 retains most of the existing requirements for financial liabilities. However, for financial liabilities designated at fair value through profit or loss, gains or losses attributable to changes in own credit risk may be presented in other comprehensive income. The Group has elected to early adopt this presentation of gains and losses on financial liabilities from 1 January 2017.

17. Future accounting developments (continued)

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 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.

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.

The new impairment requirements will result in an increase in the Group's balance sheet provisions for credit losses and may have a negative impact on the Group's regulatory capital position. The extent of any increase in provisions will depend upon a number of factors including the composition of the Group's lending portfolios and forecast economic conditions at the date of implementation. It is not possible to conclude on the capital impact as the interaction with IFRS 9 and the capital rules, including possible transitional arrangements, is still being finalised.

Whilst the Group is still running and testing the new credit risk models, it is not possible to provide a reliable estimate of the increase in impairment provisions on 1 January 2018. The ongoing impact on the financial results will only become clearer after running the IFRS 9 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.

17. Future accounting developments (continued)

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.

Revenue relating to financial instruments, leases and insurance contracts are out of scope, however, the Group does recognise fee income that is within scope, for example on added value accounts, interchange and service fees, certain mortgage fees, factoring and commitment fees. A substantial proportion of the current revenue recognition policy for fee and commission income is not expected to change. The standard is therefore not expected to have a significant impact on the Group's profitability.

Upon transition, any adjustments can be recognised either retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application as an adjustment to the opening balance retained earnings. The Group anticipates adopting the second approach to transition.

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.

IFRS 17 Insurance Contracts

IFRS 17 replaces IFRS 4 'Insurance Contracts' and is effective for annual periods beginning on or after 1 January 2021.

IFRS 17 requires insurance contracts and participating investment contracts to be measured on the balance sheet as the total of the fulfilment cash flows and the contractual service margin. Changes to estimates of future cash flows from one reporting date to another are recognised either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it. The effects of some changes in discount rates can either be recognised in profit or loss or in other comprehensive income as an accounting policy choice. The risk adjustment is released to profit and loss as an insurer's risk reduces. Profits which are currently recognised through a Value in Force asset, will no longer be recognised at inception of an insurance contract. Instead, the expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

The standard will have a significant impact on the accounting for the insurance and participating investment contracts issued by the Insurance Division.

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 IFRIC 23 'Uncertainty over Income Tax Treatments' effective 1 January 2019. These revised requirements are not expected to have a significant impact on the Group.

18. Ultimate parent undertaking

The Bank's ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland. Lloyds Banking Group plc has published consolidated accounts for the year to 31 December 2016 and copies may be obtained from Investor Relations, Lloyds Banking Group, 25 Gresham Street, London EC2V 7HN and available for download from www.lloydsbankinggroup.com.

19. Other information

The financial information in these condensed consolidated half-year financial statements does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2016 have been delivered to the Registrar of Companies. The auditors' report on those accounts was unqualified, did not include an emphasis of matter paragraph and did not include a statement under section 498 of the Companies Act 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors listed below (being all the directors of Lloyds Bank plc) confirm that to the best of their knowledge these condensed consolidated half-year financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*, as adopted by the European Union, and that the half-year management report herein includes a fair review of the information required by DTR 4.2.7R and DTR 4.2.8R, namely:

- an indication of important events that have occurred during the six months ended 30 June 2017 and their impact on the condensed consolidated half-year financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the six months ended 30 June 2017 and any material changes in the related party transactions described in the last annual report.

Signed on behalf of the board by

António Horta-Osório
Group Chief Executive
26 July 2017

Lloyds Bank plc board of directors:

António Horta-Osório (Group Chief Executive)
George Culmer (Chief Financial Officer)
Juan Colombás (Chief Risk Officer)
Lord Blackwell (Chairman)
Anita Frew (Deputy Chairman)
Alan Dickinson
Simon Henry
Lord Lupton CBE
Deborah McWhinney
Nicholas Prettejohn
Stuart Sinclair
Sara Weller CBE

INDEPENDENT REVIEW REPORT TO LLOYDS BANK PLC

Report on the condensed consolidated half-year financial statements

Our conclusion

We have reviewed Lloyds Bank plc's condensed consolidated half-year financial statements (the 'interim financial statements') in the 2017 half-year management report of Lloyds Bank plc for the six month period ended 30 June 2017. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the consolidated balance sheet as at 30 June 2017;
- the consolidated income statement for the period then ended;
- the consolidated statement of comprehensive income for the period then ended;
- the consolidated cash flow statement for the period then ended;
- the consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2017 half-year management report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The 2017 half-year management report, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the 2017 half-year management report in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the 2017 half-year management report based on our review. This report, including the conclusion, has been prepared for and only for the Bank for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the 2017 half-year management report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
London
26 July 2017

Notes:

- (a) The maintenance and integrity of the Lloyds Banking Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the interim financial statements since they were initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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Copies of this news release may be obtained from Investor Relations, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN. The full news release can also be found on the Group's website – www.lloydsbankinggroup.com.

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