Lloyds Banking Group plc

Basel II Pillar 3 Disclosures
31 December 2009

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FORWARD LOOKING STATEMENTS

This document includes certain forward looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995 with respect to the business, strategy and plans of Lloyds Banking 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 Banking Group's or its directors and / or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

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

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by Lloyds Banking Group or on Lloyds Banking Group's behalf include, but are not limited to, general economic conditions in the UK and internationally; inflation, deflation, interest rates, policies of the Bank of England and other G8 central banks, exchange rate, market and monetary fluctuations; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits, borrower credit quality, technological changes, natural and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, taxation, Government policies or accounting standards or practices and similar contingencies outside Lloyds Banking Group's control; the ability to derive cost savings and other benefits as well as mitigate exposures from the acquisition and integration of HBOS; inadequate or failed internal or external processes, people and systems; exposure to regulatory scrutiny, legal proceedings or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the ability to secure new customers and develop more business from existing customers; the degree of borrower credit quality; the ability to achieve value-creating mergers and / or acquisitions at the appropriate time and prices and the success of Lloyds Banking Group in managing the risks of the foregoing.

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

FOREWORD

This document presents the consolidated Pillar 3 disclosures of Lloyds Banking Group plc as at 31 December 2009. The publication of this document fulfils a key requirement of the Basel II Framework, encouraging market discipline by allowing market participants to assess increased disclosure surrounding both the risk management framework and the capital adequacy of the Group.

In producing this document consideration has been given to both the minimum disclosure requirements of the Basel II Framework, as interpreted through the Capital Requirements Directive ('CRD') and subsequently the UK Financial Service Authority's ('FSA') Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU'), and the work of both national and international trade associations in interpreting Pillar 3 requirements and establishing best practice guidelines.

For year end 2008 consolidated Pillar 3 disclosures were produced by the heritage banking groups, Lloyds TSB Bank plc and HBOS plc. As a result of the formation of Lloyds Banking Group plc in January 2009, following the acquisition of HBOS plc by Lloyds TSB Group plc, separate heritage banking group Pillar 3 disclosures will no longer be produced. However, in satisfaction of significant subsidiary disclosure requirements for year end 2009, summary information pertaining to the consolidated capital resources and consolidated capital requirements of Lloyds TSB Bank plc and Bank of Scotland plc has been produced within the appendices to this document.

Prior year comparatives provided within this document are primarily confined to disclosures surrounding capital resources and are presented on a statutory basis in line with the Annual Reports and Accounts of Lloyds Banking Group plc and its significant subsidiaries. Provision of further comparatives on a statutory basis is considered to be neither meaningful nor relevant given the significant impact of the acquisition of HBOS plc on the Group's results for 2009.

Differences in approach under the Basel II Framework that existed between the two heritage banking groups prior to the formation of Lloyds Banking Group plc, including the use of different internal ratings scales for retail and wholesale portfolios and different interpretations of BIPRU requirements, have meant that disclosure of comparatives on a combined businesses basis, as an alternative to the statutory basis above, is not considered appropriate. An exception to this has been made in relation to the requirement to disclose a comparison of expected losses to accounting impairment losses (p.52) in order to allow a relevant comparison to be made.

SUMMARY ANALYSIS

A high level summary analysis of the consolidated capital position and credit risk exposures of Lloyds Banking Group plc ('the Group') as at 31 December 2009 is provided below.

CAPITAL RATIOS

	Ratio %
Core tier 1 capital ratio	8.1%
Tier 1 capital ratio	9.6%
Total capital ratio	12.4%

Total capital resources as at 31 December 2009 amounted to £61.1bn, including Tier 1 capital of £47.5bn.

RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENT

Total Risk Weighted Assets ('RWA') as at 31 December 2009 amounted to £493.3bn, generating a Pillar 1 capital requirement of £39.5bn. A summary breakdown of total RWA by risk type is provided in the table below.

	Risk Weighted Assets £m
Credit risk	452,104
Counterparty credit risk	12,245
Market risk	3,619
Operational risk	25,339
Total	**493,307**

Credit risk RWAs comprise £306.6bn (68%) of RWAs calculated under the Internal Ratings Based ('IRB') Approach and £145.5bn (32%) of RWAs calculated under the Standardised Approach.

CREDIT RISK EXPOSURES

Total credit risk exposures (excluding counterparty credit risk exposures) as at 31 December 2009 amounted to £938.0bn on an exposure at default ('EAD') basis.

This total comprises £742.7bn (79%) risk weighted under the IRB Approach and £195.3bn (21%) risk weighted under the Standardised Approach. A summary analysis of credit risk exposures is provided in the table below.

Exposure Category	Credit Risk Exposure £m	Risk Weighted Assets £m	Average Risk Weight %
Corporates	168,283	157,332	93%
Central governments and central banks	15,358	1,009	7%
Institutions	40,700	9,188	23%
Retail	445,679	124,503	28%
Equities	2,115	5,304	251%
Securitisation positions	68,882	7,828	11%
Non credit obligation assets	1,674	1,454	87%
Total – IRB Approach	**742,691**	**306,618**	**41%**
Central governments and central banks	35,353	83	0%
Institutions	668	242	36%
Corporates	55,980	52,734	94%
Retail	10,152	8,085	80%
Secured on real estate property	46,959	39,371	84%
Items belonging to regulatory high risk categories	1,197	4,069	340%
Securitisation positions	971	558	57%
Other [1]	43,985	40,344	92%
Total – Standardised Approach	**195,265**	**145,486**	**75%**
TOTAL	**937,956**	**452,104**	**48%**

[1] Other exposures include exposures to regional governments and local authorities, administrative bodies and non-commercial undertakings, short term claims on institutions and corporates, past due items, collective investment undertakings and other items.

INTRODUCTION

The Capital Requirements Directive governs the implementation of the Basel II Framework within the European Union ('EU'). The purpose of this legislation is to provide a modern prudential framework for credit institutions and investment firms across the EU, improving on the previous Basel I Framework through greater risk sensitivity and reflecting more modern approaches and improvements in the risk management practices of credit institutions and investment firms.

Prudential requirements under the Basel II Framework are determined by the three pillars.

PILLAR 1 – MINIMUM CAPITAL REQUIREMENTS

The first pillar focuses on the determination of the minimum capital required to support the firm's exposure to credit, market and operational risks. A range of approaches, varying in sophistication, are available under the Basel II Framework to use in measuring these risks and determining the minimum level of capital required. The main approaches are set out in the table below.

Risk	**Complexity** **Least** ----------------	----------------►	**Most**
Credit	Standardised Approach	Foundation Internal Ratings Based Approach (FIRB)	Advanced Internal Ratings Based Approach (AIRB)
Counterparty Credit	Standardised Approach	Foundation Internal Ratings Based Approach (FIRB)	Advanced Internal Ratings Based Approach (AIRB)
Market	Standardised Approach	Internal Models Approach (IMA)	-
Operational	Basic Indicator Approach (BIA)	Standardised Approach	Advanced Measurement Approach (AMA)

Minimum capital requirements under Pillar 1 are more commonly expressed as risk weighted assets ('RWAs'), being 12.5 times the minimum capital required.

Credit Risk

The Standardised Approach to calculating credit risk capital requirements relies on the application of a standardised set of risk weightings to credit risk exposures based on the categorisation of the exposure and the criteria specified within the BIPRU provisions. External credit ratings supplied by External Credit Assessment Institutions (for example, Standard & Poor's) can be used in determining the credit quality of the exposure and therefore the appropriate risk weight to apply. The Standardised Approach also recognises the application of credit risk mitigation techniques.

The IRB Approach represents a significantly more advanced method of calculating credit risk capital requirements. It is further sub-divided into two distinct approaches – the Foundation IRB Approach and the Advanced IRB Approach. Application of either of these approaches requires approval from the FSA.

Both approaches require firms to make use of their own internal assessment of the probability of a counterparty defaulting ('PD'). In addition, firms applying the Advanced IRB Approach are required to use internal estimates of the loss given default ('LGD') and the credit conversion factors used in deriving the exposure at default ('EAD'). Firms applying the Foundation IRB Approach are also required to use LGD and EAD components within their calculations, but these are subject to standard parameters set by the regulator.

Under the IRB Approach, the three risk components (PD, LGD and EAD), together with correlation and maturity factors, are used to calculate the credit risk capital requirement applying to the exposure. This reflects the capital required to cover any unexpected loss in relation to the exposure.

The expected loss ('EL'), which is defined as the monetary amount the business expects to lose from an obligor, arising from a default in the next 12 months, is derived by multiplying the PD, LGD and EAD risk components together, as follows:

$EL = (PD\% * LGD\% * EAD)$

The expected loss is compared to the level of accounting impairment provisions raised. Where expected losses are in excess of accounting impairment provisions the resultant 'excess EL' is deducted from capital resources, split equally between Tier 1 and Tier 2 capital. Where accounting impairment provisions exceed expected losses, a 'surplus provision' may be recognised in Tier 2 capital subject to certain restrictions.

Firms applying an IRB Approach must use their model outputs to inform both credit risk management and day to day credit related decision making within the business.

Additional exposure specific approaches are available under the IRB Approach to use in place of the Foundation or Advanced IRB Approach. These include the use of the Supervisory Slotting Approach for corporate specialised lending exposures and the Simple Risk Weight Method for equity exposures. There are also specific approaches for calculating credit risk capital requirements in relation to securitisation positions.

Both the Foundation IRB Approach and the Advanced IRB Approach are used within Lloyds Banking Group, with the former applied in relation to heritage Lloyds TSB wholesale IRB portfolios and the latter for all remaining IRB portfolios within the Group, excluding those risk weighted under one of the additional exposure specific approaches noted above.

The application of both the Foundation IRB Approach and Advanced IRB Approach within Lloyds Banking Group has required a large number of internal models covering various portfolios of business to be built, tested (including a one year parallel run) and approved by the FSA prior to roll out within the relevant Division. Credit risk exposures in relation to those portfolios of business yet to roll out onto an IRB model or that have been permanently exempted from the IRB Approach are risk weighted under the Standardised Approach.

As part of the process of aligning the Group to heritage Lloyds TSB risk management policies, processes and risk appetite it is intended, in the short term, to align the regulatory capital approach for all material wholesale IRB portfolios within Wholesale Division around the Foundation IRB Approach. Application of the Advanced IRB Approach to all such portfolios remains a long term objective of the Group.

References to the 'Retail IRB Approach' within these disclosures refer to the application of the Advanced IRB Approach to retail exposures and the related requirements under the BIPRU provisions.

The Group makes use of the Supervisory Slotting Approach and the Simple Risk Weight Method for certain corporate specialised lending portfolios and equity exposures respectively.

Full details of the Group's approach to managing credit risk and an analysis of credit risk exposures at year end can be found within the Credit Risk section of the document.

Counterparty Credit Risk

Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and may include derivative contracts and repo contracts.

Measurement of counterparty credit risk exposures must follow one of three prescribed methodologies, the standardised method, the mark-to-market method or the internal model method. Once the exposure value is determined, it is risk weighted under the appropriate credit risk approach in order to determine the counterparty credit risk capital requirement.

Within Lloyds Banking Group, counterparty credit risk exposure values are determined under the mark-to-market method, with capital requirements determined under the Standardised Approach or IRB Approach, as appropriate.

Full details of the Group's approach to managing counterparty credit risk and an analysis of counterparty credit risk exposures at year end can be found within the Counterparty Credit Risk section of the document.

Market Risk

Market risk capital requirements can be determined under either the Standardised Approach or the Internal Models Approach. The latter involves the use of internal Value at Risk ('VaR') models to measure market risks and determine the appropriate capital requirement. Permission is required from the FSA before VaR models can be used for this purpose.

Lloyds Banking Group is permitted by the FSA to calculate market risk capital requirements for the trading book using its VaR models. This includes capital requirements in relation to both specific and general interest rate risks. Market risk positions not covered by the VaR model permissions are risk weighted under the Standardised Approach.

Full details of the Group's approach to managing market risk and an analysis of market risk capital requirements at year end can be found within the Market Risk section of the document.

Operational Risk

The approaches available in relation to the calculation of operational risk capital requirements are summarised below:

- The Basic Indicator Approach ('BIA') determines a capital requirement based on 15% of the 'relevant' indicator as defined in the BIPRU provisions. This indicator is generally the three year average of the sum of the firm's net interest income and net non-interest income.

- The Standardised Approach determines a capital requirement based on the average income over three years of the risk weighted relevant indicators calculated each year across specified business lines. This requires the firm's activities to be split into a number of defined business lines and a specific percentage applied to the income relevant to that business line. An Alternative Standardised Approach is also available which uses alternative indicators in relation to the business lines. Firms must meet certain qualifying criteria to be able to use the Standardised / Alternative Standardised Approaches.

- The Advanced Measurement Approach ('AMA') determines a capital requirement through the use of internal operational risk measurement systems. Use of this approach requires approval from the FSA and can only be used where internal systems for monitoring and measuring operational risk are sufficiently robust.

Within Lloyds Banking Group, operational risk capital requirements are primarily determined under the Advanced Measurement Approach. A small proportion of operational risk capital requirements relating to joint venture operations and immaterial business units are determined under the Standardised Approach.

Full details of the Group's approach to managing operational risk and an analysis of operational risk capital requirements at year end can be found within the Operational Risk section of the document.

PILLAR 2 – SUPERVISORY REVIEW PROCESS

The second pillar of the Basel II Framework is designed to assess the adequacy of a firm's capital resources by considering all material risks to the business, including those not covered or adequately addressed by the first pillar, and the impact of stress tests conducted across a variety of different economic scenarios. Furthermore, requirements under Pillar 2 encourage firms to develop, operate and evolve better risk management techniques for monitoring, measuring and managing material risks.

There are two components of Pillar 2, the Internal Capital Adequacy Assessment Process ('ICAAP') and the Supervisory Review and Evaluation Process ('SREP').

The ICAAP is a firm's own internal assessment of the overall adequacy of its capital strength in light of the material risks identified and the outcome of stress testing procedures performed.

The SREP is undertaken by the FSA in order to review and assess the firm's ICAAP and to assess the quality of the firm's risk management systems and internal controls. Based on this the FSA will make its own determination of the capital adequacy of the firm, setting a minimum capital requirement for the firm through the issue of Individual Capital Guidance ('ICG').

A summary of the Group's approach to the ICAAP and the material risks identified in addition to those captured under Pillar 1 can be found within the Capital Requirements section of the document.

PILLAR 3 – MARKET DISCIPLINE

The third pillar addresses the external publication of disclosures surrounding a firm's risk management practices, its approach to capital management, its capital resources and Pillar 1 capital requirements and a detailed analysis of its credit risk exposures.

The Basel Committee on Banking Supervision see the *'purpose of Pillar 3 – market discipline* [as being one of complementing] *the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). The Committee aims to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment process, and hence the capital adequacy of the institution'* (para. 809, 'International Convergence of Capital Measurement and Capital Standards - A Revised Framework', Basel Committee on Banking Supervision, Nov 2005).

The Basel II Framework sets out the minimum disclosures required under Pillar 3. These disclosure requirements have been interpreted by the FSA via the Capital Requirements Directive, leading to the formation of the relevant provisions within BIPRU.

In interpreting Pillar 3 disclosure requirements, the Group considers both the guidance provided under the Basel II Framework as well as the best practice guidelines established by the Pillar 3 working parties of national and international trade associations. The primary aim of these working parties continues to be to drive consensus amongst reporting firms in terms of both interpretation of Pillar 3 requirements and the nature and extent of the disclosures required.

DISCLOSURE POLICY

The following sets out a summary of the disclosure policy applied to the Lloyds Banking Group plc Basel II Pillar 3 Disclosures, including the basis of preparation, frequency, media, location and verification.

BASIS OF PREPARATION

This document contains the consolidated Pillar 3 disclosures of Lloyds Banking Group plc as at 31 December 2009, prepared in accordance with the requirements of BIPRU Chapter 11 (Disclosure – Pillar 3).

In satisfaction of certain disclosure requirements, reference has been made to the 2009 Lloyds Banking Group plc Annual Report and Accounts. This document should therefore be read in conjunction with the Annual Report and Accounts. It is however important to note that a number of significant differences exist between accounting disclosures published under International Financial Reporting Standards ('IFRS') and Pillar 3 disclosures published under Basel II which prevent direct comparison in a number of areas. Of particular note are the differences surrounding scope of consolidation and the definition of credit risk exposure.

Details on the scope of consolidation applied to the disclosures presented within this document are provided within the Scope of Consolidation section of the document.

Throughout this document, unless otherwise specified, credit risk exposures are defined as the exposure at default, prior to the application of credit risk mitigation. EAD is defined as the aggregate of drawn (on balance sheet) exposures and undrawn (off balance sheet) commitments, post application of credit conversion factors and other relevant adjustments.

FREQUENCY, MEDIA AND LOCATION

In accordance with the requirements of BIPRU Chapter 11 (Disclosure – Pillar 3), the Group will continue to make available its consolidated Pillar 3 disclosures on an annual basis.

A standalone copy of these disclosures is located on the Lloyds Banking Group plc website (http://www.lloydsbankinggroup.com/investors/financial_performance.asp).

VERIFICATION

The disclosures presented within this document are not required to be subjected to external audit. Instead, the disclosures have been verified and approved through internal governance procedures in line with the Group's disclosure policy.

SCOPE OF CONSOLIDATION

The following sets out the scope of consolidation applied to the disclosures presented within this document.

INTRODUCTION

As a banking conglomerate, Lloyds Banking Group is required to calculate consolidated capital requirements and consolidated capital resources based on the regulatory consolidation provisions applicable to banks under BIPRU Chapter 8 (Group Risk Consolidation).

REGULATORY CONSOLIDATION

The scope of regulatory consolidation for the purposes of quantifying consolidated capital requirements and consolidated capital resources extends across the banking and investment operations of the Group. All banking and investment services related undertakings included within the scope of the accounting consolidation are also included within the scope of the regulatory consolidation. There are however a number of differences in the methods by which certain undertakings are consolidated for regulatory purposes.

Subsidiary undertakings included within the regulatory consolidation are fully consolidated, with capital resources determined on a line-by-line (accounting) consolidation basis. Risk capital requirements are determined either on a line-by-line (accounting) consolidation basis or by aggregating individual subsidiaries' risk capital requirements.

Undertakings in which the Group or its subsidiaries hold a 'participation', where it is deemed that the Group exerts significant influence over the undertaking, are generally consolidated within the regulatory calculations on a proportional (pro-rata) basis. This follows line-by-line (accounting) consolidation based on the ownership share in the particular undertaking. Such undertakings include joint ventures and associates, as defined under IFRS accounting standards. In certain circumstances, participations are deducted from capital rather than proportionally consolidated.

The assets of insurance holding and operating companies within the Group are excluded from the calculation of consolidated capital requirements and consolidated capital resources. Investments in insurance undertakings are deducted from capital.

Insurance undertakings are themselves required to maintain capital adequacy under the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Insurers ('INSPRU'). As at 31 December 2009 there were no such undertakings where actual capital resources were less than the regulatory minimum required.

Investments held by the Group in respect of which it does not have the ability to exert significant influence are included within the calculation of capital requirements, being treated as equity exposures. The underlying assets of these investments are neither consolidated nor deducted.

Management practice and policy ensures that capital adequacy is maintained at all levels of banking and insurance consolidation within the Group in accordance with the appropriate regulatory requirements.

The legal and regulatory structure of the Group provides a capability for the prompt transfer of surplus capital resources over and above local regulatory requirements or repayment of liabilities when due throughout the Group. There are no current or foreseeable material, practical or legal impediments to such transfers or repayments, except in the case of Scottish Widows plc. Scottish Widows plc was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court approved Scheme of Transfer, which established protected capital support for the with-profits policyholders at the date of demutualisation.

SUB GROUP DISCLOSURES

Limited additional disclosures surrounding capital resources and capital requirements have been provided within the appendices to this document for Lloyds TSB Bank plc and Bank of Scotland plc, both on a consolidated basis, in fulfilment of significant subsidiary disclosure requirements.

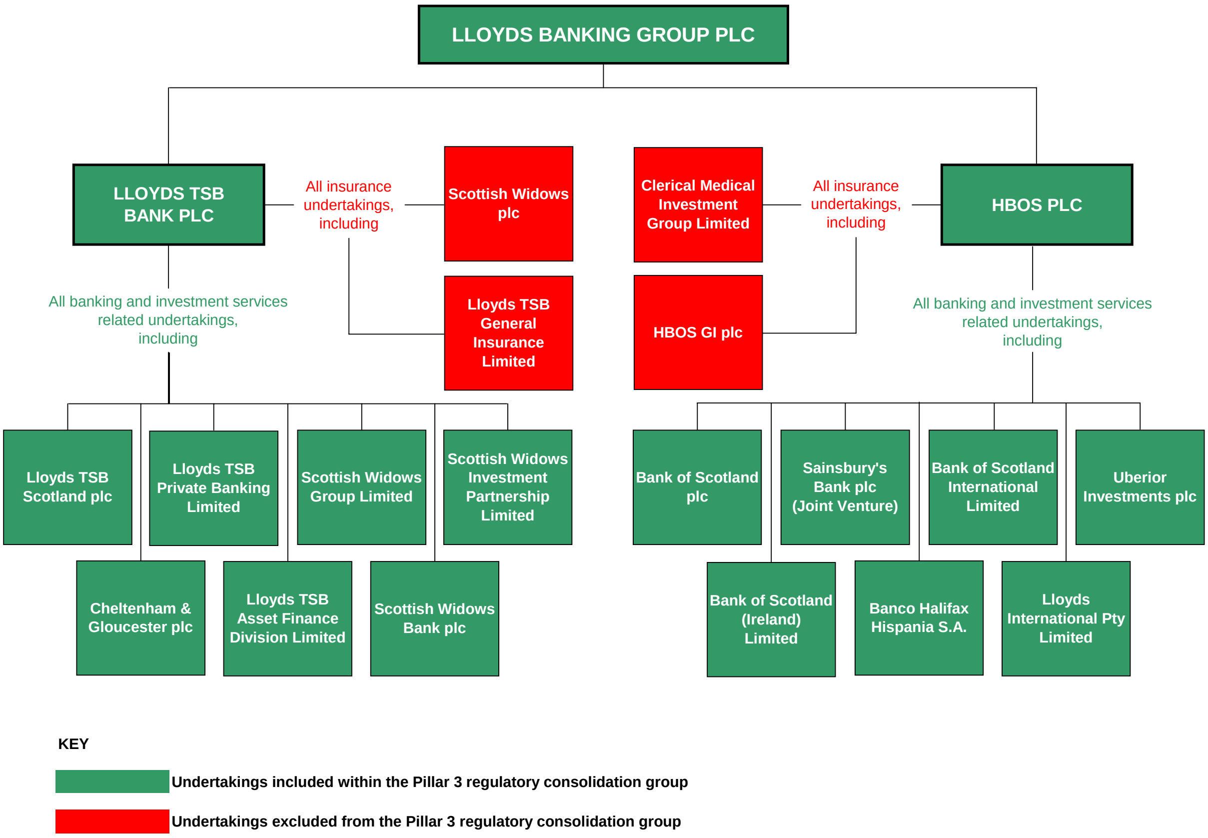
SOLO CONSOLIDATION

The Group makes use of the solo consolidation provisions set out under BIPRU Chapter 2.1 (Solo Consolidation). This allows the capital resources and capital requirements of certain specified subsidiary undertakings of Lloyds TSB Bank plc and Bank of Scotland plc to be included within the respective bank's individual capital resources and capital requirements calculations.

The application of solo consolidation provisions is subject to FSA approval and is performed in line with the terms established by the FSA for each individual bank.

REGULATORY CONSOLIDATION GROUP

A summarised diagrammatical representation (as at 31 December 2009) of the regulatory consolidation group upon which the disclosures presented within this document are based is provided below.



On 1 January 2010, as part of an internal group restructure, Lloyds Banking Group plc transferred its holding in HBOS plc to Lloyds TSB Bank plc.

RISK MANAGEMENT OBJECTIVES AND POLICY

THE GROUP'S APPROACH TO RISK

The Group’s approach to risk is founded on robust corporate governance structure and a risk management culture which guides the way all employees approach their work, the way they behave and the decisions they make. The board takes the lead by establishing the ‘tone at the top’ and approving professional standards and corporate values for itself, senior management and other colleagues. The board ensures that senior management implements strategic policies and procedures designed to promote professional behaviour and integrity. The board also ensures that senior management implements risk policies and risk appetites that either limit, or where appropriate, prohibit activities, relationships, and situations, that could diminish the quality of corporate governance. All colleagues including the group chief executive are assessed against a balanced scorecard that explicitly addresses their risk performance.

This board level engagement, coupled with the direct involvement of senior management in group-wide risk issues at group executive committee level, ensures that issues are escalated on a timely basis and appropriate remediation plans are put in place. The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by senior management. Key decisions are always taken by more than one person.

The group business risk committee and the group asset and liability committee are chaired by the group chief executive and include all members of the group executive committee. The aggregate group wide risk profile and portfolio appetite are discussed at these monthly meetings. The risk oversight committee, chaired by the senior independent director, comprises non-executive directors and oversees the Group’s risk exposures. This second-line-of-defence committee is supported by the chief risk officer, who is independent of the front line business units, is a full member of the group executive committee and reports to the group chief executive. The chief risk officer regularly informs the risk oversight committee of the aggregate risk profile and has direct access to the deputy chairman and the members of the risk oversight committee.

The Group has a conservative business model embodied by a risk culture founded on prudence and accountability, where everyone understands that they are accountable for the risks they take and that the needs of customers are paramount. The focus has been and remains on building and sustaining long-term relationships with customers, through good and bad economic times. The approach is supported by a ‘through the cycle’ approach to risk with strong central control and monitoring.

RISK AS A STRATEGIC DIFFERENTIATOR

The maintenance of a strong control framework remains a priority for the new Lloyds Banking Group and is the foundation for the delivery of effective risk management. The Group optimises performance by allowing divisions and business units to operate within approved capital, liquidity and risk parameters and within the Group’s policy framework. The Group’s approach to risk management ensures that business units remain accountable for risk whilst realising individual strategies to meet business performance targets. The combination of divisional and group risk management maintains effective independent oversight.

The Group continues to enhance its capabilities by providing to the board both qualitative and quantitative data including stress testing analysis on risks associated with strategic objectives to facilitate more informed and effective decision making. The Group‘s ability to take risks which are well understood, consistent with its strategy and plans and which are appropriately remunerated, is a key driver of shareholder return.

As part of its integration initiative, the Group has been rolling out the methodology and financial control framework that was used by the heritage Lloyds TSB Group; this includes compliance with the requirements of the US Sarbanes Oxley Act. This project is due to complete in time for reporting in February 2011.

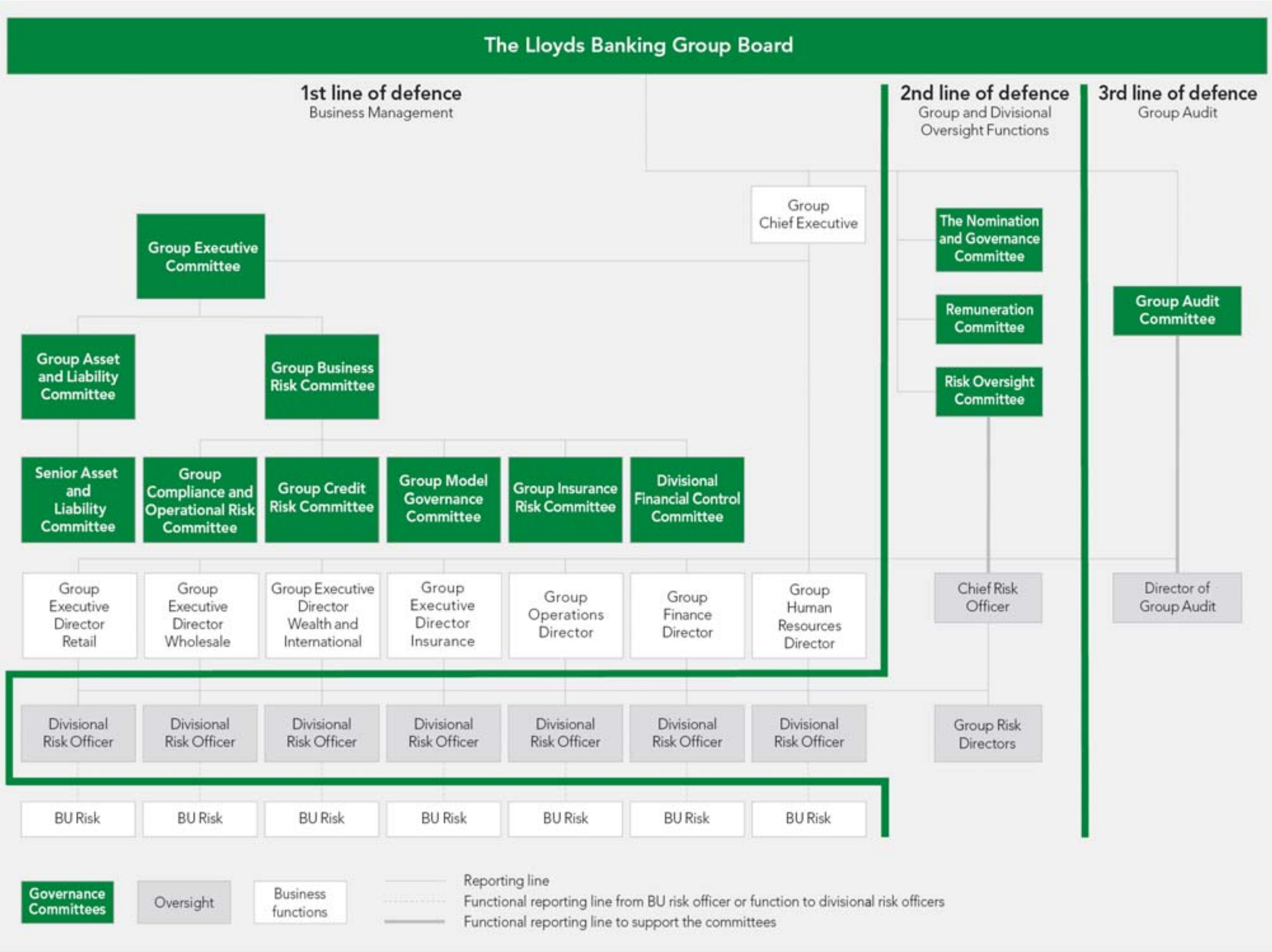
Risk analysis and reporting capabilities support the identification of opportunities as well as risks and it provides an aggregate view of the overall risk portfolio. Risk mitigation strategies clearly aligned with responsibilities and timescales are monitored at group and divisional level.

Reflecting the importance the Group places on risk management, risk is included as one of the five principal criteria within the Group’s balanced scorecard on which individual staff performance is judged. Business executives have specified risk management objectives, and incentive schemes take account of performance against these.

RISK GOVERNANCE

The Group has rolled out the heritage Lloyds TSB approach to risk appetite, policies, delegations and risk committee structure and has continued to embed these across all risk disciplines and into the business. Having achieved alignment of all high level group policies and appetites on the date of acquisition, the Group has continued to embed these at all levels.

The risk governance structure is intended to strengthen risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner. The risk governance structure for Lloyds Banking Group is shown below.



BOARD AND COMMITTEES

The board, assisted by its key risk committees (risk oversight committee and group audit committee), approves the Group's overall risk management framework. The board also reviews the Group's aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board's appetite for risk. The composition of the board and the role of the chairman, audit committee, risk oversight committee and other key risk oversight roles are described below.

The **board** is comprised of eight independent non-executive directors, including the chairman and deputy chairman, and five executive directors. The board considers that it is of an appropriate size to oversee the Group's businesses, with a suitable diversity of backgrounds and mix of experience and expertise to maximise its effectiveness. The composition of the board is kept under continuous review by the chairman, with the support of the nomination and governance committee, to ensure the right balance of skills and experience. All director appointments are subject to detailed due diligence which includes a robust search and selection process overseen by the nominations and governance committee.

The chairman is responsible for leading the board and ensuring its effectiveness while the group chief executive manages the Group's business – these are distinct functions.

The chairman is responsible for the clarity and timeliness of information provided to the board and for facilitating the effective contribution of all directors and ensures that directors receive appropriate induction and ongoing training.

The chairman has a key role in the development (jointly with the group chief executive) of the Group's strategy, as well as oversight of strategy implementation and performance delivery. He ensures that there is a constructive, close working relationship with the group chief executive and the rest of the board.

The **chairman's committee**, comprising the chairman, deputy chairman and the group chief executive, meets to assist the chairman in ensuring the effectiveness and efficiency of board meetings. The committee exercises specific powers delegated to it by the board from time to time.

The **audit committee** comprises five independent non-executive directors, including the deputy chairman. The committee's terms of reference are available from the company secretary and are displayed on the Group's website.

The audit committee receives reports from, and holds discussions with, management and the external auditors. In discharging its duties, the committee approves the auditors' terms of engagement, including their remuneration and, in discussion with them, assesses their independence and objectivity. The committee also reviews the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the group audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations; the results of the external audit and its cost effectiveness; and reports from the external auditors on audit planning and their findings on accounting and internal control systems. Procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence have been established by the committee. The committee also has meetings with the auditors, without executives present, and meetings with the group audit director alone.

To ensure that the Group's governance arrangements take due account of best practice developments, the **nomination and governance committee** has expanded its terms of reference to expressly include governance issues.

The nomination and governance committee, comprising six independent non-executive directors, including the chairman and deputy chairman, reviews the structure, size and composition of the board; oversees the selection process for prospective directors; makes recommendations to the board on potential appointments and re-appointments of directors at the end of their specified term; and considers board succession. Following expansion of its terms of reference, it also reviews the board's governance arrangements and oversees the Company's implementation of governance requirements e.g. under the Walker Review and Combined Code. The committee is responsible for overseeing the process for appointments of new non-executive directors and making recommendations to the board. The committee's terms of reference are available from the company secretary and are displayed on the Group's website.

The overarching purpose of the **remuneration committee**, which comprises seven independent non-executive directors, including the chairman and deputy chairman, is to consider, agree and recommend to the board an overall remuneration policy and philosophy for the Group that is aligned to its long-term business strategy, its business objectives, its risk appetite and values, and recognises the interests of relevant stakeholders. The remuneration policy and philosophy covers the whole Group, but the committee pays particular attention to the top management group and those colleagues who perform significant influence functions for the Group and those who could have a material impact on the Group's risk profile. The committee's role is to ensure that these colleagues are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation, whilst ensuring that there is no reward for excessive risk taking.

The committee determines the pensions policy for all colleagues and advises on other major changes to employee benefits schemes. It also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount, currently £350,000, and / or whose short-term incentive opportunity exceeds £250,000.

The committee monitors the application of the authority delegated to the group executive committee and the divisional remuneration committees to ensure that policies and principles are being fairly and consistently applied. The committee liaises with the risk oversight committee and the risk function in relation to risk-adjusted performance measures.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented. The committee's terms of reference are available from the company secretary and are displayed on the Group's website.

The remuneration committee ensures that appropriate remuneration and governance arrangements are in place throughout the organisation, with the Group functions providing an oversight role in the development of remuneration policy and practice below the senior executive population. During 2009 as part of the review of compliance with the new FSA Code of Practice on Remuneration and the developing governance environment, the committee reviewed and adopted new terms of reference. In addition divisional remuneration committees were established to ensure a strong oversight from the group remuneration committee into the divisions.

The **risk oversight committee** (the composition of which is described on p.12) oversees the development, implementation and maintenance of the group's overall risk management framework and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The risk oversight committee regularly reviews the Group's risk exposures across the primary risk drivers and the detailed risk types.

The **group executive committee**, comprising the group chief executive, all the group executive directors, together with the chief risk officer, the group human resources director and the director of group operations, meets to assist the group chief executive in performing his duties. Specifically, the committee considers the development and implementation of strategy, operational plans, policies and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources; and the monitoring of competitive forces in each area of operation. The committee, assisted by its sub-committees, the group business risk and group asset and liability committees, also supports the group chief executive in endeavouring to ensure the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and in reviewing the Group's aggregate risk exposures and concentrations of risk.

The **group asset and liability committee** is responsible for the strategic management of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility. Group asset and liability committee is supported by the **senior asset and liability committee**, which is responsible for the review of documentation relating to the management of assets and liabilities in the Group's balance sheet and the escalation of issues of group level significance to group asset and liability committee.

The **group business risk committee** reviews and recommends the Group's risk appetite and risk management framework, high-level group policies and the allocation of risk appetite. Group business risk committee periodically reviews risk exposures and risk / reward returns and monitors the development, implementation and effectiveness of the Group's risk governance framework. Within the scope of its work the committee also considers reputational risk and any issues which could have a materially adverse impact on the Group.

The group business risk committee is supported by the following committees:

– The **group compliance and operational risk committee**, which is responsible for proactively identifying current and emerging significant compliance and operational risks or accumulation of risks and control deficiencies across the Group and reviewing associated oversight plans to ensure pre-emptive risk management action. The committee also seeks to ensure that adequate divisional engagement occurs to develop, implement and maintain the Group's compliance and operational risk management framework.

– The **group credit risk committee**, which is responsible for the development and effectiveness of the Group's credit risk management framework, clear description of the Group's credit risk appetite, setting of high level Group credit policy, and compliance with regulatory credit requirements. On behalf of the group business risk committee, the group credit risk committee monitors and reviews the Group's aggregate credit risk exposures and concentrations of risk.

– The **group model governance and approvals committee**, which is responsible for setting the control framework and standards for models across the Group, including establishing appropriate levels of delegated authority, the approval of models that are considered to be material to the Group (including credit risk rating systems), and the principles underlying the Group's economic capital framework.

– The **group insurance risk committee**, which is responsible for the development and effectiveness of the Group's insurance risk management framework, clear articulation of the Group's insurance risk appetite, setting of high level insurance risk policy, and ensuring compliance with regulatory insurance requirements. On behalf of the group business risk committee, the group insurance risk committee monitors and reviews the Group's aggregate insurance risk exposures and provides proactive and robust challenge around insurance risk and business activities giving rise to insurance risk.

– During the year, the Group has created **divisional financial control committees** to provide governance over financial statements. The meetings provide review and challenge as to the veracity of the results, press release and supporting analyst information addressing the processes that have been followed in drawing them up. Items of focus are key assumptions and areas of subjectivity in the results and ensuring proper remediation of control issues that impact internal controls over financial reporting, the Group's auditors also report findings from their audit work.

The group risk directors and divisional risk officers meet on a regular basis under the chairmanship of the chief risk officer to review and challenge the risk profile of the Group and seek to ensure that mitigating actions are appropriate. Aggregate risk reports are reviewed by this group before submission to group business risk committees and then to risk oversight committee.

Group executive directors have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group's high level policies and within the parameters set by the board, group executive committee and group risk. Compliance with policies and parameters is overseen by the risk oversight committee, the group business risk committee, the group asset and liability committee, group risk and the divisional risk officers.

RISK MANAGEMENT OVERSIGHT

The chief risk officer, oversees and promotes the development and implementation of a consistent group-wide risk management framework. The chief risk officer, supported by the group risk directors and the divisional risk officers, provides objective challenge to the Group's senior management. The group executive committee and the board receive regular briefings and guidance from the chief risk officer to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

Group risk directors who report directly to the chief risk officer, are allocated responsibility for certain specific risk types and are responsible for ensuring the adequacy of the framework for their risk types as well as the oversight of the risk profile across the Group. Divisional risk officers have dual reporting lines to their own divisional executive and also to the chief risk officer and are responsible for the risk profile within their own divisions. This matrix approach enables the group executive committee members to fulfil their risk management accountabilities.

Divisional risk officers provide oversight of risk management activity for all risks within each of the Group's divisions. Reporting directly to the group executive directors responsible for the divisions and to the chief risk officer, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism.

The director of group audit provides independent assurance to the audit committee and the board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group audit is fully independent of group risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

RISK MANAGEMENT IN THE BUSINESS

Line management are directly accountable for the management of risks arising in their individual businesses. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite.

All business units, divisions and group functions complete a control self assessment annually, reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. Managing directors of each business and each group executive committee member certify the accuracy of their assessment.

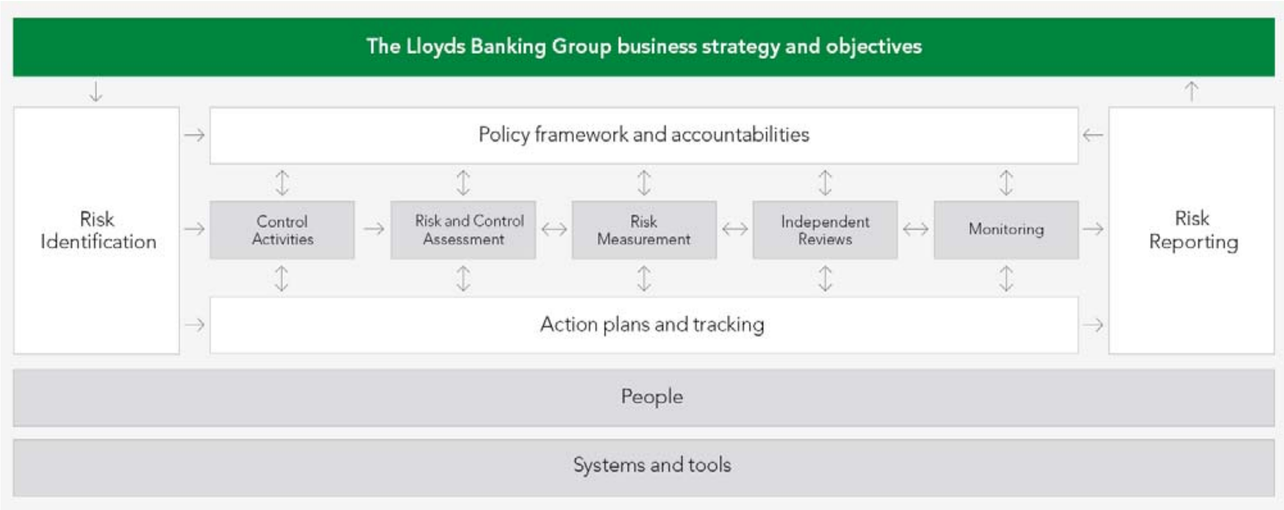
Risk management in the business forms part of a tiered risk management model, as shown on p.13, with the divisional risk officers and group risk providing oversight and challenge, as described above, and the chief risk officer and group committees establishing the group-wide perspective.

This approach seeks to provide the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also seeks to facilitate effective communication on these matters across the Group.

RISK MANAGEMENT FRAMEWORK

The Group's risk management principles and risk management framework cover the full spectrum of risks that a group, which encompasses both banking and insurance businesses, would encounter.

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assessing the impact of emerging risks from legislation, new technologies or the market, and developing risk tolerances and mitigating strategies. The framework seeks to: strengthen the Group's ability to identify and assess risks, aggregate group-wide risks and define the group risk appetite, develop solutions for reducing or transferring risk, and where appropriate, exploit risks to gain competitive advantage, thereby seeking to increase shareholder value. The principal elements of the risk management framework are shown in the table below. The framework comprises 11 interdependent activities which map to the components of the internal control integrated framework issued by the Committee of Sponsoring Organisations of the Treadway Commission.



The framework is dynamic and allows for proportionate adjustment of policies and controls where business strategy and risk appetite is amended in response to changes in market conditions.

The Lloyds Banking Group business strategy and objective is used to determine the Group's high level risk principles and risk appetite measures and metrics for the primary risk drivers (see table on p.18).

The risk appetite is proposed by the group chief executive and reviewed by various governance bodies including the group executive committee and the risk oversight committee. Responsibility for the approval of risk appetite rests with the board. The approved high level appetite and limits are delegated to individual group executive committee members by the group chief executive.

The more detailed description of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses are determined by the group chief executive, in consultation with the group business risk committee and the group asset and liability committee.

The risk principles are executed through the policy framework and accountabilities. These principles are supported by the policy levels below:

Principles – high level principles for the six primary risk drivers

High level group policy – policy statements for each of the main risk types aligned to the risk drivers

Detailed group policy – detailed policy that applies across the Group

Divisional policy – local policy that specifically applies to a division

Business unit policy – local policy that specifically applies to a business unit

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy and the associated accountabilities are clearly outlined to all colleagues. Colleagues are expected to be aware of policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all colleagues within that area.

Group and divisional risk functions have responsibility for overseeing effective implementation of policy. Group audit provides independent assurance to the board about the effectiveness of the Group's control framework and adherence to policy. Policies are reviewed annually to ensure they remain fit for purpose.

Execution of the Group's risk management framework is dependent upon a clear and consistent risk identification using a common language to define risks and to categorise them.

Proportionate control activities are in place to design mitigating controls, to transfer risk where appropriate and seeks to ensure executives are content with the residual level of risk accepted.

Risk and control assessments are undertaken to assess the effectiveness of current mitigations and whether risks taken are consistent with the Group's risk appetite (this includes the annual control self-assessment exercise).

The impact of risks and issues (including financial, reputational and regulatory capital) are determined through effective risk measurement including modelling, stress testing and scenario analysis.

The outcomes of independent reviews (including internal and external audit and regulatory reviews) are integrated into risk management activities and action plans.

Risk reporting is standardised through the use of standard definitions to enable risk aggregation. Divisions monitor their risk levels against their risk appetite, seeking to ensure effective mitigating action is being taken where appropriate. Divisional risk reports are reviewed by each divisional executive committee to ensure that respective senior management are satisfied with the overall risk profile, risk accountabilities and progress on any necessary action plans and tracking. Reporting, including that of performance against relevant limits or policies, is in place to provide a level of detail appropriate to the exposures concerned and regular information is provided to group risk for review and aggregate reporting. Any significant issues identified in the monitoring process are appropriately reported, and an escalation process is in place to report significant losses to appropriate levels of management. Regular reports are prepared by group risk on risk exposures and material issues to the group asset and liability committee, group business risk committee, group executive committee, risk oversight committee and the board.

At group level, a consolidated risk report is produced which is reviewed and debated by the group business risk committee, group executive committee, audit committee, risk oversight committee and the board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The consolidated risk report provides a regular assessment of the aggregate residual risk for the primary risk drivers, comparing the assessment with the previous quarter and providing a forecast for the next 12 months.

RISK DRIVERS

The Group’s risk language is designed to capture the Group’s ‘primary risk drivers’. These are further sub divided into 29 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out in the table below.

Primary risk drivers	Business Risk	Credit Risk	Market Risk	Insurance Risk	Operational Risk	Financial Soundness
Detailed risk types	Strategy setting Execution of strategy	Retail Wholesale	Interest rate Foreign exchange Equity Credit spread	Mortality Longevity Morbidity Persistency Property Expenses Unemployment	Legal and regulatory Customer treatment People Integration Business process risk Financial crime risk Security risk Change Governance	Capital Liquidity and funding Financial and prudential regulatory reporting Disclosure Tax

Through the Group’s risk management processes, these risks are assessed on an ongoing basis and seek to ensure optimisation of risk and reward and that, where required, appropriate mitigation is in place. Both quantitative and qualitative factors are considered in assessing the Group’s current and potential future risks.

Details on the Group's risk management processes in relation to credit risk, market risk and operational risk (the driver's of the Group's Pillar 1 capital requirement) and the management of capital resources are provided within these disclosures.

Further details on the Group's risk management processes in relation to business risk, insurance risk, liquidity and funding, financial and prudential regulatory reporting, disclosure and tax can be found in the Risk Management section of the 2009 Lloyds Banking Group plc Annual Report and Accounts (p.63 to 89).

CAPITAL RESOURCES

CAPITAL RISK

Definition

Capital risk is defined as the risk that the Group has insufficient capital to provide a sufficient resource to absorb losses or that the capital structure is inefficient.

Risk Appetite

Capital risk appetite is set by the board and reported through various metrics that enable the Group to manage capital constraints and shareholder expectations. One of the key metrics is the Group's core tier 1 capital ratio for which the board has set a target of more than 7 per cent. The chief executive, assisted by the group asset and liability committee, regularly reviews performance against risk appetite. The board formally reviews capital risk on an annual basis.

Exposure

A capital exposure arises where the Group has insufficient regulatory capital resources to support its strategic objectives and plans, and to meet external stakeholder requirements and expectations. The Group's capital management approach is focused on optimising value for shareholders.

Measurement

The Group's regulatory capital is divided into tiers depending on level of subordination and ability to absorb losses. Core tier 1 capital as defined in the FSA letter to the British Bankers Association in May 2009, comprises mainly shareholders' equity and minority interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected loss over accounting provisions and certain securitisation positions. Accounting equity is adjusted in accordance with FSA requirements, particularly in respect of pensions and available for sale assets. Tier 1 capital, defined by GENPRU, is core tier 1 capital plus tier 1 capital securities. Tier 2 capital, defined by GENPRU, comprises qualifying subordinated debt after deducting 50 per cent of the excess of expected loss over accounting provisions, and certain securitisation positions. Total capital is the sum of tier 1 and tier 2 capital after deducting investments in subsidiaries and associates that are not consolidated for regulatory purposes. In the case of Lloyds Banking Group, this means that the net assets of its life assurance and general insurance businesses are excluded from its total regulatory capital.

A number of limits are imposed by the FSA on the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities, for example the amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

The FSA requires the Group to hold sufficient regulatory capital to cover its total capital requirements under Pillar 1 and Pillar 2. In addition to this, the FSA has made further statements to explain the approach it has taken to the capital framework. These include core tier 1 and tier 1 targets under stressed conditions.

The Group undertook an extensive series of stress analysis during the year to determine the adequacy of the Group's capital resources against the FSA minimum requirements.

The Group is subject to extensive regulation and regulatory supervision in relation to the levels of capital in its business. Specifically in relation to the consultation papers issued by the Basel Committee on Banking Supervision 'Strengthening the resilience of the banking sector' the group is participating in the industry-wide consultation and calibration exercises taking place through 2010.

Mitigation

The Group has developed procedures meant to ensure that compliance with both current and potential future requirements are understood and that policies are aligned to its risk appetite.

The Group is able to raise equity either via a rights issue, placing or an open offer. Placing and open offers were completed in January as part of the Group's participation in the recapitalisation of the banking sector and in June when the Group repaid preference shares which were issued to HM Treasury as part of GAPS, and a rights issue and liability management exercise was completed in December.

The Group is also able to raise Tier 2 capital by issuing subordinated liabilities. The cost and availability of subordinated liability finance are influenced by credit ratings of both the Group and the UK's sovereign rating. A reduction in these ratings could increase the interest rate payable and could reduce market access.

The Group has in issue enhanced capital notes (ECNs) which will convert to core tier 1 capital in the event that Group's published core tier 1 ratio (as defined by the FSA in May 2009) falls below 5 per cent.

Monitoring

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the group asset and liability committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios is made to the senior asset and liability committee and to the group asset and liability committee. As part of this reporting any guidance to the market is regularly reviewed.

Capital is managed at Group level and surplus capital is retained, where possible, at Lloyds Banking Group holding company level as this provides the Group with maximum flexibility on how to deploy its capital.

MOVEMENTS IN CAPITAL

Tier 1 Capital

Core tier 1 capital increased by £30.4bn largely reflecting the issuance of share capital during the year and retained profits.

Tier 1 capital increased by £33.8bn principally as a result of the increase in core tier 1 capital. The remainder of the increase reflects the inclusion of HBOS tier 1 instruments, an increase in innovative securities of £2.0bn as part of a liability management exercise to exchange upper tier 2 debt and a further issuance of £1.2bn innovative securities in December 2009. This increase is offset by the effects of the offer of enhanced capital notes during December 2009; as part of the Group's recapitalisation and exit from GAPS, certain preference shares and preferred securities were exchanged for enhanced capital notes included within tier 2 capital.

	Core Tier 1 £m	Tier 1 £m
As at 31 December 2008	**9,542**	**13,701**
Profit attributable to ordinary shareholders	2,827	2,827
Issue of ordinary shares	29,139	29,139
Recognition of HBOS tier 1 capital instruments	-	5,653
Movement in goodwill and other intangible assets	(2,526)	(2,526)
Movement in tier 1 securities relating to ECNs exchange offer	-	(5,447)
Innovative securities exchange	-	1,959
Innovative issuance	-	1,235
Other movements	953	989
As at 31 December 2009	**39,935**	**47,530**

Tier 2 Capital

Tier 2 capital has increased in the period by £14.9bn, largely due to the acquisition of HBOS. The liability management exercises undertaken reduced tier 2 capital and increased tier 1 capital. The enhanced capital notes exchange offer completed during 2009 resulted in the exchange of certain existing tier 1 and tier 2 securities for tier 2 notes valued at £7.2bn for regulatory purposes. Under certain specified conditions, these securities would convert to ordinary share capital and increase core tier 1 capital.

Supervisory Deductions

Supervisory deductions mainly consist of investments in subsidiary undertakings that are not within the banking group for regulatory purposes. These investments are primarily the Scottish Widows and Clerical Medical life and pensions businesses.

TERMS APPLYING TO CAPITAL INSTRUMENTS

Summary information in relation to the terms and conditions attached to the main capital instruments can be found in the following Notes to the Consolidated Financial Statements contained within the 2009 Lloyds Banking Group plc Annual Report and Accounts:

- Note 44 – Subordinated Liabilities
- Note 45 – Share Capital

LLOYDS BANKING GROUP CAPITAL RESOURCES

The capital resources of the Group as at 31 December 2009 are presented in the table below.

	31 December 2009 £m	31 December 2009 £m	31 December 2008 £m	31 December 2008 £m
Core tier 1				
Ordinary share capital and reserves		44,275		9,573
Regulatory post-retirement benefit adjustments		434		435
Available-for-sale revaluation reserve		914		2,982
Cash flow hedging reserve		305		15
Other items		231		(108)
		46,159		**12,897**
Less deductions from core tier 1				
Goodwill and other intangible assets		(5,779)		(2,256)
Other deductions		(445)		(1,099)
Core tier 1 capital		**39,935**		**9,542**
Perpetual non-cumulative preference shares				
Preference share capital		2,639		1,966
Innovative tier 1 capital instruments				
Preferred securities		4,956		3,169
Less: restriction in amount eligible		-		(976)
Total Tier 1 capital		**47,530**		**13,701**
Total Tier 1 capital after deductions and restrictions (excluding innovative tier 1) [1]	***42,574***		***11,508***	
Upper tier 2				
Available-for-sale revaluation reserve in respect of equities		221		8
Undated subordinated debt		2,575		5,189
Innovative capital restricted from tier 1		-		976
Eligible provisions		2,694		21
Dated subordinated debt		20,068		5,091
Deductions from tier 2				
Other deductions		(445)		(1,099)
Total Tier 2 capital		**25,113**		**10,186**
Total Tier 2 capital after deductions and restrictions (including innovative tier 1)	***30,069***		***12,379***	
Supervisory deductions				
Unconsolidated investments – life		(10,015)		(4,208)
Unconsolidated investments – other		(1,551)		(550)
Total supervisory deductions		**(11,566)**		**(4,758)**
Total Capital Resources		**61,077**		**19,129**
Risk Weighted Assets		**493,307**		**170,490**
Core tier 1 ratio (%)		**8.1%**		**5.6%**
Tier 1 capital ratio (%)		**9.6%**		**8.0%**
Total capital ratio (%)		**12.4%**		**11.2%**

As part of the exchange offer announced in November 2009, certain preference shares, preferred securities and undated subordinated notes issued by the Group were exchanged for new ordinary shares with settlement in February 2010. Had the exchange settled in December 2009, the core tier 1 ratio would have been 8.4 per cent.

[1] The disclosure of tier 1 capital excluding innovative tier 1 instruments and tier 2 capital including innovative tier 1 instruments has been produced to meet the disclosure requirements of BIPRU Chapter 11. The traditional presentation of innovative tier 1 instruments within tier 1 capital has been maintained in the second and fourth columns as this reflects the disclosure adopted within the 2009 Lloyds Banking Group plc Annual Report and Accounts and the prescribed treatment under GENPRU. Both the application of regulatory restrictions (capital resources gearing rules) and the calculation of capital ratios assume the traditional treatment of innovative tier 1 instruments.

CAPITAL REQUIREMENTS

LLOYDS BANKING GROUP RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of the Group as at 31 December 2009 are presented in the table below. Notes in relation to the references below can be found on p.24.

(All figures are in £m)	Risk Weighted Assets	Pillar 1 Capital Requirements
CREDIT RISK		
Exposures subject to the IRB Approach		
Advanced IRB Approach		
Corporate - Main	65,914	5,273
Corporate - SME	19,021	1,522
Central governments and central banks	132	11
Institutions	7,009	561
Foundation IRB Approach		
Corporate - Main	47,437	3,795
Corporate - SME	6,114	489
Corporate - Specialised lending	11,014	881
Central governments and central banks	877	70
Institutions	2,179	174
Retail IRB Approach		
Retail - Residential mortgages	66,631	5,330
Retail - Originated, securitised residential mortgages [1]	10,731	858
Retail - Qualifying revolving retail exposures	23,854	1,908
Retail - Other retail	20,765	1,661
Retail - SME	2,522	202
Other IRB Approaches [2]		
Corporate - Specialised lending	7,832	627
Equities - Exchange traded	432	35
Equities - Private equity	2,534	203
Equities - Other	2,338	187
Securitisation positions [3]	7,828	626
Non credit obligation assets [4]	1,454	116
Total - IRB Approach	**306,618**	**24,529**
Exposures subject to the Standardised Approach		
Central governments and central banks	83	7
Regional governments or local authorities	25	2
Administrative bodies and non-commercial undertakings	323	26
Institutions	242	19
Corporates	52,734	4,219
Retail	8,085	647
Secured on real estate property	39,371	3,150
Past due items	14,186	1,135
Items belonging to regulatory high risk categories	4,069	325
Securitisation positions	558	45
Short term claims on institutions or corporates	632	50
Other items [4], [5]	25,178	2,014
Total - Standardised Approach	**145,486**	**11,639**
Total Credit Risk	**452,104**	**36,168**
COUNTERPARTY CREDIT RISK		
IRB Approach	5,692	456
Standardised Approach	6,553	524
Total Counterparty Credit Risk	**12,245**	**980**
MARKET RISK		
Internal Models Approach	2,104	168
Standardised Approach		
Interest rate PRR	1,378	110
Foreign currency PRR	128	10
Commodity PRR	9	1
Total Market Risk	**3,619**	**289**
OPERATIONAL RISK		
Advanced Measurement Approach	24,777	1,982
Standardised Approach	562	45
Total Operational Risk	**25,339**	**2,027**
TOTAL	**493,307**	**39,464**

DIVISIONAL RISK WEIGHTED ASSETS

The risk weighted assets of the Divisions as at 31 December 2009 are presented in the table below. Notes in relation to the references below can be found on p.24.

(All figures are in £m)	Retail	Wholesale	Wealth & International	Insurance	Group Ops & Central Items	TOTAL
CREDIT RISK						
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	-	65,914	-	-	-	65,914
Corporate - SME	-	18,613	408	-	-	19,021
Central governments and central banks	-	132	-	-	-	132
Institutions	-	6,988	21	-	-	7,009
Foundation IRB Approach						
Corporate - Main	-	44,077	3,319	-	41	47,437
Corporate - SME	-	6,113	1	-	-	6,114
Corporate - Specialised lending	-	10,969	45	-	-	11,014
Central governments and central banks	-	251	124	-	502	877
Institutions	-	2,176	3	-	-	2,179
Retail IRB Approach						
Retail - Residential mortgages	58,850	2,569	5,077	-	135	66,631
Retail - Originated, securitised residential mortgages [1]	10,731	-	-	-	-	10,731
Retail - Qualifying revolving retail exposures	23,854	-	-	-	-	23,854
Retail - Other retail	15,697	4,944	124	-	-	20,765
Retail - SME	-	2,522	-	-	-	2,522
Other IRB Approaches [2]						
Corporate - Specialised lending	-	6,080	1,752	-	-	7,832
Equities - Exchange traded	-	415	17	-	-	432
Equities - Private equity	-	2,534	-	-	-	2,534
Equities - Other	-	2,223	115	-	-	2,338
Securitisation positions [3]	-	7,828	-	-	-	7,828
				-	-	
Non credit obligation assets [4]	67	1,381	6	-	-	1,454
Total - IRB Approach	**109,199**	**185,729**	**11,012**	**-**	**678**	**306,618**
Exposures subject to the Standardised Approach						
Central governments and central banks	-	-	83	-	-	83
Regional governments or local authorities	-	14	11	-	-	25
Administrative bodies and non-commercial undertakings	-	307	16	-	-	323
Institutions	-	2	152	88	-	242
Corporates	125	31,900	20,093	-	616	52,734
Retail	1,103	2,069	4,913	-	-	8,085
Secured on real estate property	2,252	23,882	13,237	-	-	39,371
Past due items	1,583	4,694	7,909	-	-	14,186
Items belonging to regulatory high risk categories	-	4,069	-	-	-	4,069
Securitisation positions	20	-	538	-	-	558
Short term claims on institutions or corporates	-	606	26	-	-	632
Other items [4], [5]	2,370	8,912	1,302	960	11,634	25,178
Total - Standardised Approach	**7,453**	**76,455**	**48,280**	**1,048**	**12,250**	**145,486**
Total Credit Risk	**116,652**	**262,184**	**59,292**	**1,048**	**12,928**	**452,104**
COUNTERPARTY CREDIT RISK						
IRB Approach	-	5,692	-	-	-	5,692
Standardised Approach	-	6,535	18	-	-	6,553
Total Counterparty Credit Risk	**-**	**12,227**	**18**	**-**	**-**	**12,245**
MARKET RISK						
Internal Models Approach	-	2,104	-	-	-	2,104
Standardised Approach						
Interest rate PRR	-	1,378	-	-	-	1,378
Foreign currency PRR	-	128	-	-	-	128
Commodity PRR	-	9	-	-	-	9
Total Market Risk	**-**	**3,619**	**-**	**-**	**-**	**3,619**
OPERATIONAL RISK						
Advanced Measurement Approach	11,591	7,921	3,798	-	1,467	24,777
Standardised Approach	349	-	141	72	-	562
Total Operational Risk	**11,940**	**7,921**	**3,939**	**72**	**1,467**	**25,339**
TOTAL	**128,592**	**285,951**	**63,249**	**1,120**	**14,395**	**493,307**

Notes

[1] Originated, securitised residential mortgage exposures (Retail IRB Approach) relate to assets held through the Group's residential mortgage securitisation programmes where the associated notes in issue are held primarily by external market participants, rather than by the Group. Further details are provided in the Securitisations section of the document.

[2] Credit risk exposures subject to other IRB approaches include the following:

- Corporate specialised lending exposures risk weighted in accordance with supervisory slotting criteria;
- Equity exposures risk weighted in accordance with the Simple Risk Weight Method; and
- Securitisation positions risk weighted in accordance with the Internal Assessment Approach or Ratings Based Approach.

[3] Securitisation positions exclude amounts falling into the 1250% risk weight category under the relevant risk weight approach. These amounts are deducted from capital, after the application of value adjustments, as opposed to being risk weighted.

[4] Non credit obligation assets (IRB Approach) and other items (Standardised Approach) refer, in the main, to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, cash amounts, prepayments and accruals.

[5] Included within other items are exposures to collective investment undertakings amounting to £30m with an associated RWA of £8m.

LLOYDS BANKING GROUP PILLAR 2 CAPITAL REQUIREMENT

The Capital Resources Requirement ('CRR') is 8 per cent of risk weighted assets and represents the capital required under Pillar 1 of the Basel II Framework. In addition, the FSA currently sets Individual Capital Guidance ('ICG') for each UK bank calibrated by reference to the CRR, to address the requirements of Pillar 2 of the Basel II Framework.

A key input into the FSA's ICG setting process is each bank's Internal Capital Adequacy Assessment Process ('ICAAP'). The FSA's approach is to monitor the available resources in relation to the ICG requirement. The Group has been given an ICG by the FSA and the board has also agreed a formal buffer to be maintained in addition to this requirement. The FSA has made it clear that each ICG remains a confidential matter between each bank and the FSA.

The LBG ICAAP is based upon a 'Pillar 1 Plus' approach whereby the Pillar 1 capital requirements for Credit Risk, Operational Risk and Market Risk (Trading Book) are supplemented by assessments of the key risks not captured under Pillar 1. This not only has the advantage of consistency with Pillar 1 but also allows the Group to leverage the considerable investment it has made in developing the component Pillar 1 models in each of the risk types including:

• the detailed internal review of the models and their progressive embedding in business use; and

• the extensive external review of these models, including that of the FSA.

Some of the key risks assessed within the ICAAP include Pension Obligation Risk, Concentration Risk, Underestimation Risk and Interest Rate Risk in the Banking Book, including Basis Risk.

Pension Obligation Risk relates to the additional unplanned contribution costs that the Group would incur in the event of a significant unexpected deterioration in the funding position of the Group defined benefit pension schemes. Examples of factors which might give rise to such deterioration include a fall in medium / long term interest rates, falling equity and property prices, rising inflation or rising longevity. The risk is quantified using a market stress approach to determine the potential one year deterioration of the actuarial funding position and assumes a subsequent 15 year recovery period.

Concentration Risk occurs when a group of loans within a Credit Risk portfolio is affected by common factors that have the potential to produce higher losses than would be experienced within a fully diversified portfolio. As the Pillar 1 capital assessment has been calibrated to be appropriate for a fully diversified portfolio, the approach used by the Group to assess Concentration Risk is to compare the actual loss volatility of the current Group portfolio against that implied by the Pillar 1 assessment, at the level of the confidence used for the ICAAP.

Underestimation Risk mostly occurs where the Pillar 1 capital assessment is currently based upon the FSA's Standardised Approach but is considered as underestimating the true risk. The Group approach is to aggregate all the identified over and underestimates across both IRB and Standardised portfolios.

Interest Rate Risk in the Banking Book looks at the capital impacts in the non-trading book of an instantaneous parallel 200 basis point shock to interest rates (up and down) and a widening of the spread between Bank Base Rate and LIBOR rates.

The individual risk assessments are aggregated with no allowance for inter-risk diversification, generating an internal capital assessment.

As part of the capital planning process, forecast capital positions are subjected to an extensive stress analysis to determine the adequacy of the Group's capital resources against the minimum requirements including ICG over the forecast period.

The ICAAP is subject to a robust review process, approved by the LBG Board and submitted to the FSA.

CREDIT RISK

DEFINITION

The risk of reductions in earnings and / or value, through financial or reputational loss, as a result of the failure of the party with whom the Group has contracted to meet its obligations (both on and off balance sheet).

RISK APPETITE

Credit risk appetite is set by the board and is described and reported through a suite of metrics derived from a combination of accounting and credit portfolio performance measures which in turn use the various credit risk rating systems as inputs. These metrics are supported by a comprehensive suite of policies, sector caps, product and country limits to manage concentration risk and exposures within the Group's approved risk appetite.

This statement of the Group's overall appetite for credit risk is reviewed and approved annually by the board. With the support of the group credit risk committee and group business risk committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that credit risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer as required. These commitments can take the form of loans and overdrafts, or credit instruments such as guarantees and standby, documentary and commercial letters of credit. With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit can be cancelled and the credit worthiness of customers is monitored frequently. In addition, most wholesale commitments to extend credit are contingent upon customers maintaining specific credit standards, which are regularly monitored.

Credit risk can also arise from debt securities, private equity investments, derivatives and foreign exchange activities.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers. A significant proportion of the investments are held in unit linked and with profit funds where the shareholder risk is limited, subject to any guarantees given.

Under the Basel II Framework credit risk exposures are classified into broad categories, as defined under the IRB Approach and Standardised Approach exposure categorisations of the Framework. The methodology used for assigning exposures to different categories ('exposure classes') is consistently applied to all new exposures arising.

The IRB exposure classes applying to the business are described below. Exposures allocated to the equivalent Standardised exposure classes follow similar definitions.

Corporate Exposures

In general, this relates to exposures generated through lending and corporate financing activities in respect of servicing the needs of corporate and commercial clients ('Main') and small and medium enterprises ('SME'). Exposures also arise in relation to business conducted through 'specialised lending'.

The FSA requires that specialised lending exposures arising through the Group's business streams are separately identified from general corporate exposures.

There are four sub-classes of specialised lending recognised by the FSA. These are project finance, object finance, commodities finance and income-producing real estate ('IPRE'). Each of these sub-classes is defined under the Basel II Framework.

Specialised lending exposures are defined under the Framework as those exposures possessing all the following characteristics, either in legal form or economic substance:

- the exposure is typically to an entity – often a special purpose entity ('SPE') which was created specifically to finance and / or operate physical assets;
- the borrowing entity has little or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the asset(s) being financed;

- the terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates; and
- as a result of the preceding factors, the primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of a broader commercial enterprise.

The Group's specialised lending exposures predominantly comprise property investment and property development transactions and major asset financing deals such as shipping and aircraft.

Retail Exposures

The following exposures are generally considered to be retail exposures under the Basel II Framework:

- Retail exposures secured by real estate collateral (i.e. residential mortgages)
- Qualifying revolving retail exposures (i.e. overdrafts and credit cards)
- Exposures to retail SMEs (i.e. retail business banking)
- Other retail exposures (i.e. unsecured personal lending)

Retail SME exposures relate to the provision of business banking to sole traders, small partnerships and small businesses that do not meet the threshold for recognition as Corporate SME exposures and which are generally managed as retail exposures within Retail business streams.

Exposures to Central Governments and Central Banks

Exposures to central governments and central banks are also referred to as sovereign exposures. Certain public sector entities and Multilateral Development Banks are also included within this exposure class where they meet the relevant criteria under the BIPRU provisions.

Exposures to Institutions

This relates to exposures to other banking and financial institutions. It also includes exposures to certain domestic public sector entities and Multilateral Development Banks that do not meet the criteria for recognition as exposures to central governments and central banks but are considered to be equivalent to an exposure to an institution.

Equity Exposures

An equity interest, held either directly or indirectly, in a corporate undertaking that does not form part of the Group is considered to be an equity exposure if it meets certain additional criteria including the requirement to be irredeemable and provide entitlement to the Group to have a residual claim on the assets of the third party. Additionally, debt claims designed to mimic the features of equity interest (e.g. interest payments linked to dividends or profits) will be treated as equity exposures to capture the true economic risk of that exposure.

Securitisation Positions

Securitisation positions are defined and explained within the Securitisations section of the document.

MEASUREMENT

In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components: (i) the 'probability of default' by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and their likely future development, from which the Group derives the 'exposure at default'; and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default').

The Group assesses the probability of default of individual counterparties using internal rating models tailored to the various categories of counterparty. In its principal retail portfolios and a growing number of wholesale lending portfolios, exposure at default and loss given default models are also in use. They have been developed internally and use statistical analysis, combined, where appropriate, with external data and subject matter expert judgement. Each rating model is subject to a rigorous validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. All material rating models are authorised by the group model governance committee.

Each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between classifications if the assessment of the obligor probability of default changes. Each rating system is required to map to a master scale, which supports the consolidation of credit risk information across portfolios through the adoption of a common rating scale. Given the differing risk profiles and credit rating considerations, the underlying risk reporting has been split into two distinct master scales, a retail master scale and a wholesale master scale.

The rating systems described above assess probability of default, exposure at default and loss given default, in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment. Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss models that are used for internal operational management and banking regulation purposes.

MONITORING

Portfolio monitoring and reporting: In conjunction with group risk, businesses and divisions identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. Group risk in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to both the group credit risk committee and to the group business risk committee.

The performance of all rating models is comprehensively monitored on a regular basis, to seek to ensure that models continue to provide optimum risk differentiation capability, the generated ratings remain as accurate and robust as possible and the models assign appropriate risk estimates to grades / pools. All models are monitored against a series of agreed key performance indicators. In the event that monthly monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated to the group model governance committee.

APPROACH

The Group has largely adopted the heritage Lloyds TSB credit risk approach, including governance structure, sanctioning processes and risk appetite controls and framework. Integrated, prudent through the cycle credit policies and procedures have mostly all been established and implemented across the Group, supported by robust early warning indicators and triggers.

Following a prioritised appointment process an integrated credit risk management structure is in place throughout the Group, using the most experienced and skilled resources from both heritages. Substantial work has been undertaken to analyse portfolios and where necessary the Group has taken actions to manage effectively its exposure through the economic downturn. These actions have included revised credit criteria for key products and a withdrawal from those business sectors that are outside of the Group's risk appetite.

The Group has formed a group level Credit Risk Assurance function with experienced credit professionals from both heritages. Together with Divisional Risk senior management, this team has carried out an independent risk-based review of the high risk wholesale and retail books. Nearly £150 billion of high risk wholesale assets, primarily HBOS commercial real estate and corporate exposures, have been reviewed by the team. This has required a detailed file by file review of the original credit application, subsequent management papers and an understanding of the supporting collateral. In addition, portfolio level analysis and investigation, together with statistically robust sampling of accounts, have been carried out for over £300 billion of retail assets. These comprehensive reviews have greatly enhanced the Group's knowledge and understanding of the legacy portfolios and have enabled the Group to assess and manage these exposures confidently and effectively.

To support corporate customers that encounter difficulties during the current economic downturn the Group has continued to expand its dedicated Business Support Unit (BSU) model. Teams have been strengthened in both Wholesale and Wealth and International to deal with the rise in work loads experienced during the year as the recessionary conditions took hold both in the UK and overseas. In Wholesale three teams have been created to cover Corporate Real Estate, Corporate and Commercial, and Specialist Finance customers experiencing difficulties. In Wealth and International teams have been created in Ireland and Australia. Under this model, relationship management passes early and fully to BSU; because the BSU specialists receive the customers at an earlier stage in the process they have more time to develop effective solutions. The strategy is to work alongside management teams and key stakeholders to turnaround businesses in distress and re-establish these as viable entities. Where a turnaround is not feasible, exposure is minimised through a combination of appropriate asset sales, restructuring and work out strategies.

To support UK Retail customers who are encountering financial difficulties the Group has launched a cross-channel support programme. Lloyds TSB branches and telephony units have at least one trained Financial Health Specialist providing customers with budgeting and money management advice. In the Group's Halifax and Bank of Scotland businesses, customers have a dedicated telephone support line with trained specialists able to guide them through any financial difficulties. Support is also available for all customers online, and via a specially developed support brochure. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities that require restructuring.

Within Collections and Recoveries the sharing of best practice and alignment of policies across the Group, has helped to drive more effective customer outcomes and achieve operational efficiencies. The Group has strengthened resources in Collections and Recoveries to help customers in distress by offering advice and access to a wider range of options such as short-term repayment plans or the government backed Homeowners' Mortgage Support and Mortgage Rescue schemes. A core element of our relationship management approach is to contact customers showing signs of financial distress, discussing with them their circumstances and offering solutions to prevent their accounts falling into arrears. This year, nearly a quarter of a million customers have been contacted who were not yet in arrears.

The Group follows a through the economic cycle, relationship based, business model with robust risk management processes, appropriate appetites and experienced staff in place. These robust policies and procedures define chosen target market and risk acceptance criteria. These have been, and will continue to be, tightened and fine tuned as appropriate and include the use of early warning indicators to help anticipate future areas of concern and allow us to take early and proactive mitigating actions.

CREDIT RISK EXPOSURE: ANALYSIS BY EXPOSURE CLASS

As at 31 December 2009 the total credit risk exposures of the Group amounted to £938.0bn.

Credit risk exposures by exposure class are provided in the table below, together with the associated RWA, average risk weight and average credit risk exposure.

Exposure Class	Credit Risk Exposure £m	Risk Weighted Assets £m	Average Risk Weight %	Average Credit Risk Exposure [6] £m
Exposures subject to the IRB Approach				
Advanced IRB Approach				
Corporate - Main	39,991	65,914	165%	41,206
Corporate - SME	14,344	19,021	133%	15,601
Central governments and central banks	1,052	132	13%	3,257
Institutions	21,015	7,009	33%	24,974
Foundation IRB Approach				
Corporate - Main	83,190	47,437	57%	83,162
Corporate - SME	7,224	6,114	85%	7,015
Corporate - Specialised lending	11,362	11,014	97%	10,729
Central governments and central banks	14,306	877	6%	5,487
Institutions	19,685	2,179	11%	36,664
Retail IRB Approach				
Retail - Residential mortgages	313,376	66,631	21%	316,510
Retail - Originated, securitised residential mortgages [1]	58,661	10,731	18%	60,435
Retail - Qualifying revolving retail exposures	45,200	23,854	53%	43,729
Retail - Other retail	25,289	20,765	82%	26,604
Retail - SME	3,153	2,522	80%	3,073
Other IRB Approaches [2]				
Corporate - Specialised lending	12,172	7,832	64%	12,526
Equities - Exchange traded	149	432	290%	144
Equities - Private equity	1,334	2,534	190%	1,415
Equities - Other	632	2,338	370%	854
Securitisation positions [3]	68,882	7,828	11%	78,130
Non credit obligation assets [4]	1,674	1,454	87%	1,558
Total - IRB Approach	**742,691**	**306,618**	**41%**	**773,073**
Exposures subject to the Standardised Approach				
Central governments and central banks	35,353	83	0%	39,720
Regional governments or local authorities	82	25	30%	102
Administrative bodies and non-commercial undertakings	373	323	87%	392
Institutions	668	242	36%	687
Corporates	55,980	52,734	94%	67,806
Retail	10,152	8,085	80%	11,894
Secured on real estate property	46,959	39,371	84%	49,161
Past due items	12,118	14,186	117%	10,965
Items belonging to regulatory high risk categories	1,197	4,069	340%	1,113
Securitisation positions	971	558	57%	562
Short term claims on institutions or corporates	632	632	100%	1,171
Other items [4], [5]	30,780	25,178	82%	25,325
Total - Standardised Approach	**195,265**	**145,486**	**75%**	**208,898**
TOTAL	**937,956**	**452,104**	**48%**	**981,971**

Notes

[1] Originated, securitised residential mortgage exposures (Retail IRB Approach) relate to assets held through the Group's residential mortgage securitisation programmes where the associated notes in issue are held primarily by external market participants, rather than by the Group. Further details are provided in the Securitisations section of the document.

[2] Credit risk exposures subject to other IRB approaches include the following:

- Corporate specialised lending exposures risk weighted in accordance with supervisory slotting criteria;
- Equity exposures risk weighted in accordance with the Simple Risk Weight Method; and
- Securitisation positions risk weighted in accordance with the Internal Assessment Approach or Ratings Based Approach.

[3] Securitisation positions exclude amounts falling into the 1250% risk weight category under the relevant risk weight approach. These amounts are deducted from capital, after the application of value adjustments, as opposed to being risk weighted.

[4] Non credit obligation assets (IRB Approach) and other items (Standardised Approach) refer, in the main, to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, cash amounts, prepayments and accruals.

[5] Included within other items are exposures to collective investment undertakings amounting to £30m with an associated RWA of £8m.

[6] Average credit risk exposure represents the average exposure across the year to 31 December 2009.

CREDIT RISK EXPOSURE: ANALYSIS BY DIVISION

An analysis of total credit risk exposures by Division is provided below.

Division	Risk Weight Approach	Credit Risk Exposure £m
Retail	IRB	421,405
	Standardised	11,415
Wholesale	IRB	292,020
	Standardised	107,190
Wealth & International	IRB	24,404
	Standardised	56,161
Insurance	IRB	-
	Standardised	1,272
Group Ops & Central Items	IRB	4,862
	Standardised	19,227
Total		**937,956**

CREDIT RISK EXPOSURE: ANALYSIS BY INDUSTRY

Credit risk exposures as at 31 December 2009, analysed by major industrial sector, are provided in the table below.

(All figures are in £m)	Agriculture, forestry and fishing	Energy and water supply	Manufacturing	Construction	Transport, distribution and hotels	Postal and comms	Property companies	Financial, business and other services	Personal: Mortgages	Personal: Other	Lease Financing	Hire purchase	TOTAL
Exposures subject to the IRB Approach													
Advanced IRB Approach													
Corporate - Main	2	1,799	2,982	4,421	7,504	-	10,980	11,958	345	-	-	-	**39,991**
Corporate - SME	31	281	1,113	972	3,409	-	4,375	4,113	44	6	-	-	**14,344**
Central governments and central banks	-	-	-	-	-	-	-	1,052	-	-	-	-	**1,052**
Institutions	-	-	-	-	-	-	-	21,015	-	-	-	-	**21,015**
Foundation IRB Approach													
Corporate - Main	341	1,973	11,478	2,734	9,482	1,618	10,888	41,266	-	-	3,128	282	**83,190**
Corporate - SME	310	6	780	144	729	233	2,766	1,623	-	-	23	610	**7,224**
Corporate - Specialised lending	3	-	1	266	92	-	10,037	963	-	-	-	-	**11,362**
Central governments and central banks	-	1	1	-	-	-	-	14,304	-	-	-	-	**14,306**
Institutions	-	-	-	-	-	-	-	18,719	-	-	966	-	**19,685**
Retail IRB Approach													
Retail - Residential mortgages	777	1	176	262	944	16	1,916	892	308,391	1	-	-	**313,376**
Retail - Originated, securitised residential mortgages	-	-	-	-	-	-	-	-	58,661	-	-	-	**58,661**
Retail - Qualifying revolving retail exposures	-	-	-	-	-	-	-	-	-	45,200	-	-	**45,200**
Retail - Other retail	1	-	2	2	10	-	2	8	-	20,003	219	5,042	**25,289**
Retail - SME	231	2	238	456	741	23	239	863	-	135	-	225	**3,153**
Other IRB Approaches													
Corporate - Specialised lending	2	460	82	631	2,017	12	5,967	2,129	-	-	872	-	**12,172**
Equities - Exchange traded	-	-	1	-	2	-	-	146	-	-	-	-	**149**
Equities - Private equity	-	-	-	-	-	-	-	1,334	-	-	-	-	**1,334**
Equities - Other	-	43	43	-	8	-	65	473	-	-	-	-	**632**
Securitisation positions	305	1	135	160	1,179	22	1,514	65,565	1	-	-	-	**68,882**
Total – IRB Approach	**2,003**	**4,567**	**17,032**	**10,048**	**26,117**	**1,924**	**48,749**	**186,423**	**367,442**	**65,345**	**5,208**	**6,159**	**741,017**
Exposures subject to the Standardised Approach													
Central governments and central banks	-	-	-	-	-	-	-	35,279	-	-	74	-	**35,353**
Regional governments or local authorities	-	-	-	-	-	-	-	40	-	-	42	-	**82**
Administrative bodies and non-commercial undertakings	-	66	-	-	-	-	-	276	-	-	31	-	**373**
Institutions	-	-	1	88	-	-	-	579	-	-	-	-	**668**
Corporates	1,521	2,106	3,252	6,532	12,127	1,555	6,129	15,549	1,256	825	4,258	870	**55,980**
Retail	1,298	259	76	394	174	6	423	563	5	5,397	407	1,150	**10,152**
Secured on real estate property	9	-	72	402	700	-	28,468	1,916	15,392	-	-	-	**46,959**
Past due items	178	94	457	1,768	2,551	-	2,554	1,948	1,729	662	68	109	**12,118**
Items belonging to regulatory high risk categories	-	-	272	69	209	-	51	596	-	-	-	-	**1,197**
Securitisation positions	-	-	1	32	3	-	222	1	297	303	-	112	**971**
Short term claims on institutions or corporates	113	82	28	5	72	-	184	131	17	-	-	-	**632**
Total – Standardised Approach	**3,119**	**2,607**	**4,159**	**9,290**	**15,836**	**1,561**	**38,031**	**56,878**	**18,696**	**7,187**	**4,880**	**2,241**	**164,485**
Total	**5,122**	**7,174**	**21,191**	**19,338**	**41,953**	**3,485**	**86,780**	**243,301**	**386,138**	**72,532**	**10,088**	**8,400**	**905,502**
Non credit obligation assets / Other items													**32,454**
Total Credit Risk Exposure													937,956

CREDIT RISK EXPOSURE: ANALYSIS BY GEOGRAPHY

Credit risk exposures as at 31 December 2009, analysed by geographical area based on the country of residence of the customer, are provided in the table below.

(All figures are in £m)	United Kingdom	Rest of Europe	United States of America	Asia-Pacific	Other	TOTAL
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	36,233	80	3,678	-	-	**39,991**
Corporate - SME	14,140	52	152	-	-	**14,344**
Central governments and central banks	36	938	-	78	-	**1,052**
Institutions	2,505	10,918	5,606	1,180	806	**21,015**
Foundation IRB Approach						
Corporate - Main	54,771	11,918	12,060	748	3,693	**83,190**
Corporate - SME	7,159	36	6	-	23	**7,224**
Corporate - Specialised lending	9,435	1,380	100	49	398	**11,362**
Central governments and central banks	6	9,651	2,132	2,266	251	**14,306**
Institutions	4,479	11,224	2,298	741	943	**19,685**
Retail IRB Approach						
Retail - Residential mortgages	306,660	6,716	-	-	-	**313,376**
Retail - Originated, securitised residential mortgages	58,661	-	-	-	-	**58,661**
Retail - Qualifying revolving retail exposures	45,200	-	-	-	-	**45,200**
Retail - Other retail	24,965	324	-	-	-	**25,289**
Retail - SME	3,153	-	-	-	-	**3,153**
Other IRB Approaches						
Corporate - Specialised lending	3,250	5,155	2,984	326	457	**12,172**
Equities - Exchange traded	22	38	59	1	29	**149**
Equities - Private equity	1,015	180	139	-	-	**1,334**
Equities - Other	530	82	7	1	12	**632**
Securitisation positions [1]	27,837	11,999	25,564	929	2,553	**68,882**
Total – IRB Approach	**600,057**	**70,691**	**54,785**	**6,319**	**9,165**	**741,017**
Exposures subject to the Standardised Approach						
Central governments and central banks	33,126	585	-	1,564	78	**35,353**
Regional governments or local authorities	70	-	-	11	1	**82**
Administrative bodies and non-commercial undertakings	307	-	-	63	3	**373**
Institutions	369	78	58	126	37	**668**
Corporates	22,838	15,059	4,421	11,423	2,239	**55,980**
Retail	5,703	1,299	330	2,375	445	**10,152**
Secured on real estate property	28,158	16,207	167	1,555	872	**46,959**
Past due items	4,057	5,236	679	2,057	89	**12,118**
Items belonging to regulatory high risk categories	1,084	-	2	-	111	**1,197**
Securitisation positions	264	255	-	452	-	**971**
Short term claims on institutions or corporates	375	95	123	-	39	**632**
Total – Standardised Approach	**96,351**	**38,814**	**5,780**	**19,626**	**3,914**	**164,485**
Total	**696,408**	**109,505**	**60,565**	**25,945**	**13,079**	**905,502**
Non credit obligation assets / Other items						**32,454**
Total Credit Risk Exposure						**937,956**

[1] Securitisation positions (IRB Approach) have been analysed on a country of risk basis as this better reflects the profile of exposures held.

CREDIT RISK EXPOSURE: ANALYSIS BY RESIDUAL MATURITY

Credit risk exposures as at 31 December 2009, analysed by residual contractual maturity, are provided in the table below.

(All figures are in £m)	On demand	Repayable in 3 months or less	Repayable between 3 months and 1 year	Repayable between 1 and 5 years	Repayable over 5 years or undated	TOTAL
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	2,173	2,137	3,429	22,758	9,494	**39,991**
Corporate - SME	1,805	2,213	2,029	4,459	3,838	**14,344**
Central governments and central banks	-	-	264	735	53	**1,052**
Institutions	89	1,459	1,658	13,112	4,697	**21,015**
Foundation IRB Approach						
Corporate - Main	6,299	7,936	8,859	42,806	17,290	**83,190**
Corporate - SME	828	150	469	3,153	2,624	**7,224**
Corporate - Specialised lending	640	728	659	6,714	2,621	**11,362**
Central governments and central banks	42	8,405	266	544	5,049	**14,306**
Institutions	115	6,915	6,350	4,517	1,788	**19,685**
Retail IRB Approach						
Retail - Residential mortgages	1,924	821	4,924	21,249	284,458	**313,376**
Retail - Originated, securitised residential mortgages	34	255	888	6,107	51,377	**58,661**
Retail - Qualifying revolving retail exposures	45,200	-	-	-	-	**45,200**
Retail - Other retail	403	1,001	2,552	15,966	5,367	**25,289**
Retail - SME	1,936	25	101	620	471	**3,153**
Other IRB Approaches						
Corporate - Specialised lending	264	1,208	1,318	5,749	3,633	**12,172**
Equities - Exchange traded	-	-	-	94	55	**149**
Equities - Private equity	-	-	-	41	1,293	**1,334**
Equities - Other	-	-	-	33	599	**632**
Securitisation positions	110	2,360	14,976	7,752	43,684	**68,882**
Total – IRB Approach	**61,862**	**35,613**	**48,742**	**156,409**	**438,391**	**741,017**
Exposures subject to the Standardised Approach						
Central governments and central banks	27,508	2,115	38	111	5,581	**35,353**
Regional governments or local authorities	-	1	1	80	-	**82**
Administrative bodies and non-commercial undertakings	1	1	64	139	168	**373**
Institutions	131	366	63	106	2	**668**
Corporates	1,537	3,092	5,104	28,100	18,147	**55,980**
Retail	1,510	323	494	5,012	2,813	**10,152**
Secured on real estate property	395	3,469	4,534	15,692	22,869	**46,959**
Past due items	773	1,822	701	3,966	4,856	**12,118**
Items belonging to regulatory high risk categories	-	103	-	2	1,092	**1,197**
Securitisation positions	-	5	30	639	297	**971**
Short term claims on institutions or corporates	249	383	-	-	-	**632**
Total – Standardised Approach	**32,104**	**11,680**	**11,029**	**53,847**	**55,825**	**164,485**
Total	**93,966**	**47,293**	**59,771**	**210,256**	**494,216**	**905,502**
Non credit obligation assets / Other items						**32,454**
Total Credit Risk Exposure						**937,956**

PAST DUE EXPOSURES, IMPAIRED EXPOSURES AND IMPAIRMENT PROVISIONS

DEFINITION

For accounting and prudential purposes, past due but not impaired exposures, impaired exposures and impairment provisions are defined as follows:

- **Past due but not impaired exposures:** An exposure is past due when a counterparty has failed to make a payment when contractually due.
- **Impaired exposures:** An exposure where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.
- **Impairment provisions:** Impairment provisions are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.

ACCOUNTING POLICY

The Group's accounting policy in respect of impaired exposures ('financial assets') and impairment provisions raised in respect of loans and receivables is detailed below.

Assets accounted for at amortised cost

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition and prior to the balance sheet date, there is objective evidence that a financial asset or group of financial assets has become impaired.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

– Delinquency in contractual payments of principal and/or interest;

– Indications that the borrower or group of borrowers is experiencing significant financial difficulty;

– Restructuring of debt to reduce the burden on the borrower;

– Breach of loan covenants or conditions; and

– Initiation of bankruptcy or individual voluntary arrangement proceedings.

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

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between two months and twelve months.

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset’s original effective interest rate. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate.

For the Group’s portfolios of smaller balance homogenous loans, such as the residential mortgage, personal lending and credit card portfolios, allowances are calculated for groups of assets taking into account historical cash flow experience. For the Group’s other lending portfolios, allowances are established on a case-by-case basis. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

If there is no objective evidence of individual impairment the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower’s ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

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

Available-for-sale financial assets

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

MANAGING IMPAIRED EXPOSURES AND IMPAIRMENT PROVISIONS

Group Provisioning Policy

The high level principles and policies of the group in respect of the management of impaired exposures, the setting of impairment provisions and the write-off of impaired exposures are contained within the Group Credit Impairment Policy, approved by the group business risk committee, with recommendation from the group credit and business risk director, and reviewed annually.

The policy has been developed and is maintained by group credit risk who formulate and agree, in conjunction with Group Finance and the Divisions, the policy for the treatment of impaired assets with the group business risk committee.

Adequacy reviews

All assets whether impaired or unimpaired, are considered for impairment on a quarterly basis. The process followed is exactly the same as that used in determining whether or not an asset is impaired and if it is, whether it should fall within the individually assessed or collectively assessed category.

Assets previously identified as impaired are reviewed to ensure that the objective evidence of impairment remains valid, that cashflow projections (including any potential net proceeds from realisation of collateral) remain appropriate and that the impairment loss recorded in the bank's books continues to reflect the difference between the net present value and the carrying value of the asset. In the event that the future expected cashflow has changed from the previous assessment, an adjustment to the level of loss allowance is made as appropriate.

Where these impaired assets are within a pool of similar assets and are assessed collectively, the relevance of the pool within which the asset has been placed and the assumptions regarding cashflow emanating from the pool is considered.

Upon review, if it can be evidenced that the impairment event has passed without detriment to the future expected cashflow and the net present value is greater than the carrying value of the asset, the asset can be re-categorised as unimpaired.

Any asset that has, following an impairment event, been rescheduled / restructured over a longer term and / or at a lower interest rate than the original terms and conditions and / or any element of interest and / or principal has been forgiven, continues to be classified as impaired, even if the net present value of the future cashflow is greater than the current carrying value of the asset.

Loss allowances are raised in the same currency as the pool of impaired assets to which they relate.

Reporting

All significant new impaired asset exposures are reported by their respective group business area as soon as they arise. On a regular basis, an analysis of significant impaired exposures (including levels and trends in impaired exposures, loan volume trends and changes in lending criteria) is provided to the group business risk committee and the group credit risk committee.

At key half year and full year financial reporting periods, an Impairment Adequacy Report, summarising individual and collective impairment provisions, write-offs and other impairment provisioning issues, including risk elements and results, is submitted to each of the group business risk committee and the audit committee. The group credit risk committee and group risk monitor impairment provisions on a continuous basis throughout the year.

A monthly reporting pack is produced by each Division which covers significant movements in the impairment provisions in the current month and the year to date, highlighting the charge to profit and loss (including recoveries), amounts written off in the period and a detailed analysis of the closing impairment provision requirement.

In addition, comprehensive monthly reporting packs are produced by the Divisional Business Support Units, which actively manage distressed assets.

The Group reviews regularly, but at least annually, its provision forecast against actual experience to identify whether its policies resulted in over or under provisioning across the economic cycle. The responsibility for the review rests with Divisions who report bi-annually to the group credit risk committee and audit committee on its findings and recommendations.

ANALYSIS OF PAST DUE AND IMPAIRED LOANS AND ADVANCES TO CUSTOMERS

The analysis provided within this section has been presented on an accounting consolidation basis rather than a regulatory consolidation basis.

As at 31 December 2009, past due but not impaired exposures in respect of loans and advances to customers amounted to £19.6bn. Impaired exposures in respect of loans and advances to customers amounted to £58.8bn, of which £9.1bn were classified as 'impaired – no provision required' and the remaining £49.7bn as 'impaired – provision held'.

Analysis by Industry

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2009, by major industrial sector, is provided in the table below.

	Past due but not impaired		Impaired	
	£m	As a % of credit risk exposure	£m	As a % of credit risk exposure
Agriculture, forestry and fishing	107	2.09%	143	2.79%
Energy and water supply	113	1.58%	952	13.27%
Manufacturing	85	0.40%	2,492	11.76%
Construction	403	2.08%	4,355	22.52%
Transport, distribution and hotels	993	2.37%	7,211	17.19%
Postal and communications	3	0.09%	26	0.75%
Property companies	2,788	3.21%	19,911	22.94%
Financial, business and other services	715	0.29%	7,732	3.18%
Personal: Mortgages	12,587	3.26%	7,952	2.06%
Personal: Other	1,532	2.11%	7,056	9.73%
Lease financing	41	0.41%	196	1.94%
Hire purchase	211	2.51%	807	9.61%
Total	**19,578**	**2.09%**	**58,833**	**6.27%**

Analysis by Geography

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2009, by country of residence of the customer, is provided in the table below.

	Past due but not impaired		Impaired	
	£m	As a % of credit risk exposure	£m	As a % of credit risk exposure
United Kingdom	16,632	2.39%	43,526	6.25%
Rest of Europe	2,504	2.29%	10,238	9.35%
United States of America	67	0.11%	2,776	4.58%
Asia-Pacific	300	1.16%	2,084	8.03%
Other	75	0.57%	209	1.60%
Total	**19,578**	**2.09%**	**58,833**	**6.27%**

ANALYSIS OF IMPAIRMENT PROVISIONS IN RESPECT OF LOANS AND ADVANCES TO CUSTOMERS

The analysis provided within this section has been presented on an accounting consolidation basis rather than a regulatory consolidation basis.

The movement in impairment provisions, from 31 December 2008 to 31 December 2009, in respect of loans and advances to customers is provided below.

	£m
At 31 December 2008	3,459
Exchange and other adjustments	95
Amounts written off	(4,200)
Recoveries of advances written off in previous years	110
Unwinding of discount	(446)
Charge to the income statement	15,783
At 31 December 2009	**14,801**
(Lloyds Banking Group plc Annual Report and Accounts 2009, p.174)	

Analysis by Industry

An analysis of closing impairment provisions, the net charge to the income statement and amounts written off in respect of loans and advances to customers, by major industrial sector, is provided in the table below.

	Impairment provisions £m	Net charge £m	Amounts written off £m
Agriculture, forestry and fishing	33	29	5
Energy and water supply	70	55	28
Manufacturing	699	737	148
Construction	527	842	336
Transport, distribution and hotels	1,621	1,783	80
Postal and communications	5	14	9
Property companies	5,504	5,528	51
Financial, business and other services	2,388	2,193	308
Personal: Mortgages	489	368	77
Personal: Other	2,884	3,779	3,063
Lease financing	224	241	26
Hire purchase	357	214	69
Total	**14,801**	**15,783**	**4,200**

Analysis by Geography

An analysis of closing impairment provisions, the net charge to the income statement and amounts written off in respect of loans and advances to customers, by country of residence of the customer, is provided in the table below.

	Impairment provisions £m	Net charge £m	Amounts written off £m
United Kingdom	18,574	15,447	9,362
Rest of Europe	4,100	3,468	297
United States of America	2,134	2,240	442
Asia-Pacific	985	980	282
Other	195	175	2
	25,988	22,310	10,385
Fair value adjustments [1]	(11,187)	(6,527)	(6,185)
Total	**14,801**	**15,783**	**4,200**

[1] Analysis of closing impairment provisions, the net charge to the income statement and amounts written off in respect of loans and advances to customers, by country of residence of the customer, has been presented prior to the application of acquisition related fair value adjustments. Such adjustments are not analysed on a geographical basis within the business.

IMPAIRED LOANS AND ADVANCES TO BANKS

As at 31 December 2009, loans and advances to banks amounting to £153m were deemed to be impaired. Impairment provisions held in respect of these impaired balances amounted to £149m. An analysis of the movement in impairment provisions, from 31 December 2008 to 31 December 2009, is provided below.

	£m
At 31 December 2008	135
Exchange and other adjustments	17
Amounts written off	-
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	(3)
At 31 December 2009	**149**
(Lloyds Banking Group plc Annual Report and Accounts 2009, p.174)	

IMPAIRED DEBT SECURITIES CLASSIFIED AS LOANS AND RECEIVABLES

As at 31 December 2009, impairment provisions held in respect of debt securities classified as loans and receivables amounted to £430m. An analysis of the movement in impairment provisions, from 31 December 2008 to 31 December 2009, is provided below.

	£m
At 31 December 2008	133
Exchange and other adjustments	49
Amounts written off	-
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	248
At 31 December 2009	**430**
(Lloyds Banking Group plc Annual Report and Accounts 2009, p.174)	

FACTORS IMPACTING LOSS EXPERIENCE

During 2009 the Group experienced a significant rise in impairment levels in its lending portfolios. This largely represents falls in the value of commercial real estate and the impact of the economic deterioration during the year, including the effects of rising unemployment and reduced corporate cash flows, although the effects of some of these issues started to reduce in the second half of the year. This increase in impairment levels was however partially offset by the accelerated unwind of credit related fair value adjustments taken at the time of the HBOS acquisition. The impairment charge in the second half of 2009 was 21 per cent lower than in the first half of the year, reflecting the peak of overall impairments in the first half.

In Retail, impairment losses increased, reflecting the increase in UK unemployment during 2009 on the unsecured charge, which was partly offset by a lower secured impairment charge as house prices stabilised. Compared to 2009, the Group expects to see a reduction in the Retail impairment charge in 2010 with further improvements thereafter as the UK economic environment improves and house prices continue to stabilise.

The Wholesale charge for impairment losses increased significantly, reflecting, in particular, the year-on-year decline in commercial property valuations and reduced levels of corporate cash flows. In particular, the real estate related lending exposures in the legacy HBOS portfolios were more sensitive to the downturn in the economic environment.

The Group continues to believe that the overall Wholesale impairment charge peaked in the first half of 2009 and that the Group has seen significant reduction in the Wholesale impairment charge in the second half of 2009. Further significant reductions are expected in 2010 and beyond, assuming current economic expectations. The Group has spent a significant amount of time analysing and addressing the issues in the legacy HBOS portfolios, with the greatest attention paid to the over concentration in real estate related lending and those portfolios that fall outside the Lloyds TSB risk appetite. As a result of the Group's portfolio review, which applied prudent assumptions to real estate asset expectations, and with the deterioration in the economy translating into lower commercial property valuations, the Group took prudent and material impairment charges especially in the first half of the year.

In the Wealth and International business the impairment charge increased, reflecting significant provisions against the Group's Irish and Australian commercial real estate portfolios. The Group continues to have ongoing concerns with regard to the outlook for the Irish economy although the Group expects 2009 to have been the peak for the International impairment charge.

The Group is confident that the overall impairment charge peaked during 2009. Although it would normally be expected that impairments would peak one to two years after the low point of a recession, given the significant Wholesale charge during the year, predominantly driven by the HBOS property and property related portfolios and HBOS (UK and US) corporate portfolios, the Group believes that the charge in 2010 will be significantly lower than the 2009 charge. The impairment charge in the second half of 2009 was 21 per cent lower than that in the first half of the year. Given our current economic outlook, the Group expects to see a similar pace of half-yearly improvement throughout 2010, with further substantial reductions in 2011 and beyond.

EXPOSURES SUBJECT TO THE INTERNAL RATINGS BASED APPROACH

The Group operates different heritage IRB models and regulatory permissions for IRB Pillar 1 credit risk calculations. The Group uses both Foundation IRB and Advanced IRB approaches. The extent to which these approaches are applied to credit portfolios within the Group is set out in the analysis of credit risk exposures that precedes this section.

Irrespective of regulatory approach, implementation of Foundation IRB models or Advanced IRB models is rigorously controlled through consistent development, validation and governance standards. IRB models are put through a stringent internal assessment process, a minimum of a one year parallel run and material models are subject to additional FSA scrutiny before they are allowed to go live for regulatory capital purposes.

SCOPE OF THE IRB PERMISSION

The Foundation IRB Approach is applied to heritage Lloyds TSB wholesale portfolios. Foundation IRB models in respect of these portfolios are fully rolled out.

The Advanced IRB Approach is applied to heritage HBOS wholesale portfolios and to the Group's retail portfolios (Retail IRB Approach). Model roll out in respect of the heritage HBOS wholesale portfolios has been partially completed. The majority of the Advanced IRB models yet to roll out relate to heritage HBOS portfolios within the Wholesale and Wealth & International Divisions. Advanced IRB models in respect of the Group's retail portfolios are fully rolled out.

Portfolios whose associated models have yet to roll out, or where no model roll out is planned, are risk weighted under the Standardised Approach. A summary of Standardised RWAs as at 31 December 2009, by heritage and division is provided below.

Heritage	Total Standardised RWA (£bn)	Of which				
		Wholesale	Retail	W & I	Group	Insurance
HBOS	127.8	54%	6%	34%	5%	1%
LTSB	17.7	41%	2%	25%	31%	1%

A number of Standardised portfolios are permanently exempted from the IRB approach and will remain on the Standardised Approach, whilst others are on parallel run, with a view to migration to IRB in due course. The timing and intended regulatory approach for models yet to roll out is under review as part of the Group's integration activity.

The Group target IRB environment is that a consistent calculation is undertaken across the Group for identical exposure classes. As a consequence the Group intends, in the short term, to adopt the Foundation IRB Approach across all material wholesale portfolios within Wholesale Division as part of a common regulatory approach and will seek to rationalise the model suite and capital calculation approaches to deliver an efficient and accurate regulatory capital calculation. An updated model roll out plan to achieve this aim is under development. As a consequence this has moderated the pace of model roll out across the heritage HBOS wholesale portfolios. Adoption of the Advanced IRB Approach across all such portfolios remains a long term objective of the Group.

Certain credit risk exposures categorised under the Specialised Lending and Equity exposure classes are subject to alternative approaches that fall under the BIPRU provisions governing the IRB Approach. These include the Supervisory Slotting Approach for specialised lending and the Simple Risk Weight Method for equities. Further details on the exposures subject to these approaches can be found within the Credit Risk Exposure analysis section of this document.

Securitisation exposures are subject to specific risk weighting methodologies, including the Ratings Based Approach. Further details on the securitisation exposures subject to this approach can be found within the Securitisations section of the document.

INTERNAL DEVELOPMENT AND MONITORING OF ADVANCED IRB MODELS

Models are governed and controlled by the group model governance and approvals committee ('MGC'). Committee members comprise of the Chief Risk Officer, Group Finance Director, Group Analytics and Risk Modelling Director and a representative from each of the Divisional Risk teams. MGC is responsible for approving material models and for setting the governance framework and standards for all risk models across the Group. Material models are defined as those which contribute 3% or greater of the Group's credit RWA or where the portfolio exposure is more than £20bn.

Group Risk Model Governance Policy and a set of Mandatory Group Manuals ('MGM') set out IRB model control framework. Group Risk Model Governance Policy prescribes the overarching principles that apply to risk models. MGMs provide a baseline standard for all risk models and all risk model related activity covering; data integrity, model implementation, development and validation, forecasting and stress testing, usage of IRB credit models and model review and approval.

Model review must be annually undertaken and independent of the development process, covering the following aspects; design, validation, conservatism, calibration, sensitivity analysis / stress testing, operational aspects, usage, governance, independence, regulatory compliance and performance monitoring and reporting.

Independent, ongoing assessments of adherence to the risk model governance framework and processes are undertaken through a combination of internal audit and the second line assurance teams in divisional and group risk functions.

INTERNAL APPLICATION OF THE ADVANCED IRB APPROACH

The Group not only utilises IRB models in the regulatory capital calculation process, the models are also widely used in the business.

Credit approval

Group risk sets out the Group credit principles and policy according to which credit risk is managed, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Divisional and business unit policy includes lending guidelines, which define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions.

Credit Limits

Prudent sanctioning and control procedures lie at the heart of the Group's credit regime with the fundamental structure built upon:

- A risk differentiated, hierarchical approach to control, driven by size of exposure, credit and nature of risk;
- Approvals provided either via individual delegated sanctioning authorities or by dual sanctioning or by specific Credit Committees;
- Separate authorities for different types of credit risk (sovereign / bank / non bank);
- Authorities based on business need, and on the credit competence of the individuals concerned, rather than position within the Group hierarchy;
- Tight control procedures which must govern review frequency and account management responsibility; and
- Noting and reporting protocols ensure that significant exposures, within the Group, are subject to additional monitoring and review.

Pricing

The relative value inherent in the extension of credit risk exposure is considered in establishing the price appropriate to such exposure to ensure that the return is commensurate with the risks of the transaction proposed, taking account of the board's Credit Risk Appetite.

- Irrespective of market, budgetary or competitor influences, there exists a base price below which the Group's limited capital may not be utilised for new business. Such base price will constitute the minimum acceptable, as established in the strategy of each Group business;
- Each Group business has established guidelines for its range of products that reflect upside revenue potential and opportunities as well as downside procedural / control aspects.
- Pricing reflects the principle of risk / reward and the Risk Appetite defined by the Board, whilst recognising that no reward can justify the acceptance of excessive risk.

For Retail Division, pricing and decision making are intrinsically linked. The lifetime expected losses ('LEL') are fed into the profit model, along with other costs, to allow a price to be set that generates the required return. All pricing decisions have been assessed using the LEL to ensure that current pricing passes the required hurdle rates dependant on the risk involved.

For Wholesale Division, the pricing model facilitates the incorporation of pricing information into the credit approval process.

For Wholesale Markets and Treasury & Trading, major activities are funding, liquidity and hedging in external markets on behalf of the wider Group. Treasury is not normally a market maker in the markets within which it operates and is therefore dependant on prices quoted to it by the market.

Portfolio Reporting

Credit Risk reporting is conducted at both Group and Divisional levels, embedding IRB parameters into management information. This includes analysis of the core model outputs, being PD, LGD, EAD and EL measures. Model performance and parameter assessment are also presented.

INTERNAL RATING SCALES

Within the Group, probability of default ('PD') internal rating scales are used in assessing the credit quality of the Foundation and Advanced IRB portfolios. Two separate scales exist within the business – a Retail Master Scale which covers all relevant retail portfolios and a Wholesale Master Scale which covers all relevant corporate, central government and central bank and institution portfolios.

PD Master Scales

Wholesale Master Scale

PD Grade	Range		
	Lower	Mid	Upper
1	0.000%	0.005%	0.010%
2	0.011%	0.018%	0.025%
3	0.026%	0.063%	0.100%
4	0.101%	0.311%	0.510%
5	0.511%	1.751%	3.000%
6	3.001%	11.501%	20.000%
7	20.001%	60.000%	99.999%
Default	100.000%	-	-

Retail Master Scale

PD Grade	Range		
	Lower	Lower	Lower
0	0.000%	0.050%	0.100%
1	0.101%	0.251%	0.400%
2	0.401%	0.601%	0.800%
3	0.801%	1.001%	1.200%
4	1.201%	1.851%	2.500%
5	2.501%	3.501%	4.500%
6	4.501%	6.001%	7.500%
7	7.501%	8.751%	10.000%
8	10.001%	12.001%	14.000%
9	14.001%	17.001%	20.000%
10	20.001%	25.001%	30.000%
11	30.001%	37.501%	45.000%
12	45.001%	72.500%	99.999%
Default	100.000%	-	-

The Group's internal rating scales contain a similar number of rating grades to major external rating agency scales. However, the basis of the underlying rating philosophies differ and as such it is not appropriate to map internal rating scales directly to external rating agency scales.

A detailed analysis, by PD Grade, of credit risk exposures subject to the Advanced and Foundation IRB approaches is provided in the sections that follow. Retail exposures subject to the Advanced IRB Approach have been separately analysed under the heading of exposures subject to the Retail IRB Approach.

ANALYSIS OF EXPOSURES SUBJECT TO THE ADVANCED IRB APPROACH

This section provides a detailed analysis, by PD Grade, of non-retail credit risk exposures subject to the Advanced IRB Approach.

Disclosures provided in the tables below take into account any PD floors or LGD floors specified by regulators in respect of the calculation of regulatory capital requirements.

Corporate Exposures

As at 31 December 2009, corporate exposures subject to the Advanced IRB Approach totalled £54.3bn.

Corporate Main exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
1	90	0.03%	50.81%	15.75%	31	30
2	1,069	0.03%	11.41%	6.62%	329	329
3	2,881	0.06%	18.06%	10.83%	615	615
4	1,364	0.18%	12.43%	17.90%	265	265
5	6,245	1.58%	52.03%	129.91%	2,234	2,135
6	13,625	6.73%	47.24%	189.05%	3,120	3,099
7	4,797	30.79%	55.16%	322.17%	924	899
Default	9,920	100.00%	59.38%	160.79%	733	704
Total	**39,991**	**31.05%**	**47.71%**	**164.83%**	**8,251**	**8,076**

Corporate SME exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
1	21	0.03%	45.54%	10.30%	11	11
2	1	0.03%	71.22%	9.95%	1	1
3	68	0.06%	61.48%	13.79%	37	27
4	5	0.33%	54.21%	42.69%	1	1
5	2,763	1.80%	35.28%	76.71%	557	525
6	5,270	6.83%	36.12%	116.06%	781	752
7	1,347	30.04%	44.32%	225.36%	135	132
Default	4,869	100.00%	60.93%	158.87%	511	497
Total	**14,344**	**39.62%**	**45.29%**	**132.60%**	**2,034**	**1,946**

Central Government and Central Bank Exposures

As at 31 December 2009, central government and central bank exposures subject to the Advanced IRB Approach totalled £1.1bn.

Central Governments and Central Banks exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
1	634	0.01%	56.00%	10.21%	-	-
2	112	0.02%	56.00%	13.64%	-	-
3	306	0.03%	56.00%	16.95%	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	**1,052**	**0.02%**	**56.00%**	**12.54%**	**-**	**-**

Institution Exposures

As at 31 December 2009, institution exposures subject to the Advanced IRB Approach totalled £21.0bn.

Institutions exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
1	987	0.03%	23.11%	7.27%	-	-
2	2,666	0.03%	11.24%	6.58%	-	-
3	7,597	0.07%	48.44%	26.10%	41	41
4	8,929	0.35%	50.28%	42.63%	5	5
5	637	0.69%	48.73%	96.14%	-	-
6	90	7.19%	77.00%	278.49%	-	-
7	-	-	-	-	-	-
Default	109	100.00%	100.00%	100.00%	-	-
Total	**21,015**	**0.75%**	**43.71%**	**33.35%**	**46**	**46**

ANALYSIS OF EXPOSURES SUBJECT TO THE FOUNDATION IRB APPROACH

This section provides a detailed analysis, by PD Grade, of credit risk exposures subject to the Foundation IRB Approach.

Disclosures provided in the tables below take into account any PD floors specified by regulators in respect of the calculation of regulatory capital requirements.

Corporate Exposures

As at 31 December 2009, corporate exposures subject to the Foundation IRB Approach totalled £101.8bn.

Corporate Main exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average Risk Weight %
1	4,760	0.03%	12.11%
2	1,355	0.03%	15.27%
3	17,419	0.04%	23.66%
4	30,382	0.26%	45.71%
5	20,822	1.38%	99.67%
6	4,657	6.02%	149.70%
7	865	43.50%	106.46%
Default	2,930	100.00%	-
Total	**83,190**	**4.76%**	**57.02%**

Corporate SME exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average Risk Weight %
1	-	-	-
2	-	-	-
3	801	0.04%	28.54%
4	798	0.28%	48.46%
5	3,316	1.68%	86.22%
6	1,856	8.45%	130.92%
7	97	37.66%	194.12%
Default	356	100.00%	5.89%
Total	**7,224**	**8.41%**	**84.63%**

Specialised Lending exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average Risk Weight %
1	-	-	-
2	-	-	-
3	275	0.06%	29.46%
4	3,578	0.30%	66.04%
5	6,613	1.48%	114.28%
6	569	7.54%	177.95%
7	-	-	-
Default	327	100.00%	-
Total	**11,362**	**4.21%**	**96.93%**

Central Government and Central Bank Exposures

As at 31 December 2009, central government and central bank exposures subject to the Foundation IRB Approach totalled £14.3bn.

Central Governments and Central Banks exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average Risk Weight %
1	11,992	0.01%	6.13%
2	2,283	0.02%	5.84%
3	26	0.03%	15.68%
4	-	-	-
5	3	1.65%	94.20%
6	1	7.68%	177.77%
7	-	-	-
Default	1	100.00%	-
Total	**14,306**	**0.02%**	**6.13%**

Institution Exposures

As at 31 December 2009, institution exposures subject to the Foundation IRB Approach totalled £19.7bn.

Institutions exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average Risk Weight %
1	24	0.03%	10.31%
2	3,044	0.03%	8.93%
3	14,426	0.04%	8.33%
4	1,881	0.19%	29.67%
5	144	1.67%	94.70%
6	5	11.32%	194.86%
7	-	-	-
Default	161	100.00%	-
Total	**19,685**	**0.89%**	**11.07%**

ANALYSIS OF EXPOSURES SUBJECT TO THE RETAIL IRB APPROACH

This section provides a detailed analysis, by PD Grade, of retail credit risk exposures subject to the Retail IRB Approach.

Disclosures provided in the tables below take into account any PD floors or LGD floors specified by regulators in respect of the calculation of regulatory capital requirements.

As at 31 December 2009, retail exposures subject to the Retail IRB Approach totalled £445.7bn, including £58.7bn of securitised residential mortgage exposures.

Residential Mortgage exposures, inclusive of securitised amounts, by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
0	137,598	0.06%	13.75%	2.24%	2,996	1,265
1	106,157	0.27%	17.59%	9.63%	798	217
2	43,400	0.68%	18.96%	19.83%	587	361
3	13,464	0.98%	16.19%	21.24%	40	10
4	25,754	1.67%	22.51%	41.52%	162	111
5	14,508	3.11%	18.39%	46.46%	4,731	2,140
6	8,087	6.02%	26.74%	102.10%	212	61
7	3,867	9.74%	25.22%	118.96%	9	6
8	2,656	11.68%	17.87%	91.18%	24	20
9	1,989	16.72%	17.86%	101.81%	11	10
10	2,052	24.59%	21.51%	131.31%	1	-
11	1,949	38.22%	18.54%	110.10%	3	2
12	2,942	66.72%	17.24%	65.47%	3	1
Default	7,614	100.00%	19.36%	145.61%	11	-
Total	**372,037**	**3.77%**	**16.99%**	**20.79%**	**9,588**	**4,204**

Undrawn commitments disclosed under PD Grade 5 relate to pipeline mortgage applications which are risk weighted in accordance with average parameters under the appropriate model.

Residential Mortgage exposures, net of securitised amounts, by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
0	112,019	0.06%	14.39%	2.32%	2,919	1,244
1	88,747	0.26%	17.71%	9.60%	706	205
2	37,331	0.66%	18.61%	19.20%	570	358
3	12,582	0.98%	16.34%	21.45%	36	10
4	21,848	1.68%	21.66%	40.11%	159	110
5	13,373	3.09%	17.83%	44.66%	4,730	2,140
6	6,755	6.01%	26.12%	99.68%	212	61
7	3,235	9.63%	24.97%	117.17%	8	6
8	2,481	11.66%	18.29%	93.28%	24	20
9	1,857	16.74%	18.21%	103.81%	11	10
10	1,835	24.51%	21.56%	131.63%	1	-
11	1,753	38.09%	18.59%	110.56%	3	2
12	2,646	66.68%	17.16%	65.14%	3	1
Default	6,914	100.00%	20.05%	145.70%	11	-
Total	**313,376**	**4.01%**	**17.19%**	**21.26%**	**9,393**	**4,167**

An analysis of securitised residential mortgage exposures by PD Grade is provided on p.61.

Qualifying Revolving Retail Exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
0	3,807	0.05%	78.90%	2.90%	2,380	3,375
1	11,760	0.23%	63.97%	7.93%	19,392	10,028
2	6,413	0.62%	64.34%	17.70%	9,411	5,196
3	2,402	0.98%	61.18%	24.46%	3,400	1,492
4	4,177	1.93%	63.55%	41.39%	3,138	2,199
5	3,801	3.76%	60.03%	62.85%	2,099	1,542
6	2,006	6.41%	66.43%	98.23%	792	497
7	1,699	7.93%	60.46%	105.45%	371	588
8	1,656	11.62%	59.62%	128.17%	461	317
9	971	15.90%	68.79%	173.51%	185	231
10	3,456	27.95%	59.82%	113.06%	1,606	1,119
11	544	34.64%	71.30%	182.87%	86	66
12	519	64.67%	69.57%	171.21%	16	15
Default	1,989	100.00%	55.63%	181.46%	65	1
Total	**45,200**	**9.74%**	**64.15%**	**52.77%**	**43,402**	**26,666**

Under PD Grades 0, 7 and 9 undrawn commitments post credit conversion exceed the gross undrawn equivalents on the assumption that future drawings will be higher than the current limit.

Other Retail exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
0	16	0.09%	85.01%	19.92%	-	-
1	831	0.32%	60.98%	33.66%	-	-
2	3,059	0.68%	59.97%	53.06%	18	3
3	1,059	0.99%	76.28%	81.66%	-	-
4	6,452	1.71%	57.84%	75.60%	19	4
5	3,517	3.14%	60.23%	89.99%	16	3
6	3,526	5.35%	61.54%	97.38%	12	2
7	777	8.58%	63.07%	107.89%	6	1
8	1,274	11.52%	59.84%	112.60%	2	1
9	267	17.52%	68.63%	144.28%	10	4
10	662	22.40%	65.40%	153.19%	12	3
11	516	38.10%	59.31%	165.70%	1	-
12	629	74.01%	66.52%	118.28%	-	-
Default	2,704	100.00%	61.90%	46.03%	-	-
Total	**25,289**	**16.68%**	**61.09%**	**82.11%**	**96**	**21**

Retail SME exposures by PD Grade

PD Grade	Credit Risk Exposure £m	Exposure Weighted Average PD %	Exposure Weighted Average LGD %	Average Risk Weight %	Undrawn Commitments (Gross) £m	Undrawn Commitments (Post Credit Conversion Factor) £m
0	-	-	-	-	-	-
1	1	0.26%	16.44%	8.45%	-	-
2	981	0.62%	56.92%	80.14%	797	766
3	9	1.13%	10.21%	11.38%	-	-
4	549	1.55%	57.45%	72.11%	182	184
5	279	2.84%	53.86%	77.57%	59	62
6	425	5.89%	38.26%	60.62%	38	40
7	105	8.18%	50.11%	83.98%	13	11
8	211	10.63%	61.69%	111.66%	37	43
9	169	18.67%	68.05%	155.96%	21	25
10	1	24.85%	28.37%	70.69%	-	-
11	49	35.92%	67.25%	187.69%	3	4
12	56	77.81%	70.87%	119.55%	8	9
Default	318	100.00%	9.44%	37.10%	4	-
Total	**3,153**	**15.53%**	**50.38%**	**79.99%**	**1,162**	**1,144**

ANALYSIS OF EXPOSURES SUBJECT TO SUPERVISORY SLOTTING AND THE SIMPLE RISK WEIGHT METHOD

Specialised lending exposures subject to supervisory slotting

Specialised lending exposures subject to supervisory slotting are assigned to a grade, the determination of which takes into account the following factors:

- financial strength e.g. market conditions, financial ratios, stress analysis, financial structure, cash flow predictability, market liquidity and degree of over-collateralisation of trade;
- political and legal environment e.g. political risks, country risks, force majeure risks, government support, stability of legal and regulatory environment, enforceability of contracts and collateral and security;
- transaction and / or asset characteristics e.g. location, design and technology risks, construction risks, completion guarantees, financial strength of contractors and reliability, operating risks, off-take risks, supply risks, financing terms, resale values, value sensitivities and susceptibility to damage;
- strength of the sponsor and developer including any public private partnership income stream e.g. sponsor's financial strength, quality of financial disclosure, sponsor's support, reputation and track record, trading controls and hedging policies; and
- security package e.g. assignment of contracts and accounts, pledge of assets, lender's control over cash flow, covenant package, reserve funds, nature of lien, quality of insurance coverage, asset control and inspection rights.

The detailed criteria applying to each of the factors above is set out within BIPRU. Differing criteria apply to each of the main specialised lending categories i.e. project finance, income-producing real estate, object finance and commodities finance.

Once assigned to a grade, the exposure is risk weighted in accordance with the risk weight applicable to that grade and remaining maturity banding.

As at 31 December 2009, total credit risk exposures in respect of specialised lending subject to supervisory slotting criteria amounted to £12.2bn. Risk weighted assets arising from this amounted to £7.8bn as analysed in the table below.

Grade	Remaining Maturity <2.5 years		Remaining Maturity >2.5 years	
	Exposure £m	Risk Weighted Assets £m	Exposure £m	Risk Weighted Assets £m
1) Strong	88	44	2,642	1,728
2) Good	381	268	989	891
3) Satisfactory	1,058	1,217	429	494
4) Weak	914	2,284	362	906
5) Default [1]	4,415	-	894	-
Total	**6,856**	**3,813**	**5,316**	**4,019**

[1] Exposures categorised as 'default' do not attract a risk weighting but are instead treated as expected loss deductions at a rate of 50% of the exposure value.

Equity exposures subject to the Simple Risk Weight Method

The Simple Risk Weight Method is used for calculating risk weighted asset positions in respect of equity exposures.

As at 31 December 2009, total credit risk exposures in respect of equities subject to the Simple Risk Weight Method amounted to £2.1bn. Risk weighted assets arising from this amounted to £5.3bn.

An analysis of equity exposures categorised and risk weighted under the Simple Risk Weight Method is provided in the table below.

	Credit Risk Exposure £m	Risk Weighted Asset £m
Privately traded equity exposures – 190% [1]	1,334	2,534
Publicly traded equity exposures – 290%	149	432
Other equity exposures – 370%	632	2,338
Total	**2,115**	**5,304**

[1] Where privately traded equity exposures are in sufficiently diversified portfolios.

Further information on equity exposures is provided on pages 57 to 58.

COMPARISON OF EXPECTED LOSSES TO ACCOUNTING IMPAIRMENT LOSSES

The table below provides a comparison of gross expected losses as at 31 December 2008 to the net charge to the income statement (impairment losses) for the year to 31 December 2009, in respect of credit risk exposures subject to the IRB Approach.

Expected losses in relation to the Group's IRB portfolios are derived from the underlying IRB models, being a function of the associated PD, LGD and EAD estimates, and represent the potential loss on a portfolio over a 12 month period. Where expected losses on a portfolio exceed the impairment provisions raised against the portfolio, the 'excess' is deducted from capital, split equally between tier 1 and tier 2 capital.

As IRB models are developed to meet precise regulatory requirements under the Basel II Framework, the expected losses generated by these models are not directly comparable to impairment losses derived under IFRS accounting standards. In particular;

- Accounting impairment losses seek to measure loss on the basis of the economic conditions at the balance sheet date. However expected loss calculations are predicated on loss estimates that are based on economic downturn conditions.

- Expected Loss calculations forecast potential losses arising from accounts that currently exhibit no indication of impairment. However accounting impairment losses specifically exclude any customers that are currently operating with the terms of the credit agreement.

- Expected losses in relation to portfolios that are based on through-the-cycle ('TTC') PD estimates utilise historic default experience, whereas accounting impairment losses are based on the loss incurred at a point-in-time ('PIT').

- Expected loss calculations anticipate additional drawings made by customers who are yet to default (EAD estimate). Accounting impairment losses reflect exposures value and conditions at the balance sheet date.

In addition, expected losses in relation to credit portfolios that have rolled out onto IRB models during the year will not be reflected in the expected losses total at the start of the year as these portfolios were, at the time, subject to the Standardised Approach. Impairment losses for the year will reflect losses in relation to these rolled out portfolios.

In comparing expected losses to accounting impairment losses, consideration of the above differences must be taken into account.

	Expected losses as at 31 December 2008 [1] £m	Impairment losses for the year to 31 December 2009 [2] £m
Advanced IRB Approach		
Corporate (Main and SME)	4,094	5,927
Central governments and central banks	-	-
Institutions	152	-
Foundation IRB Approach		
Corporate (Main, SME and Specialised lending)	1,151	984
Central governments and central banks	2	-
Institutions	76	-
Retail IRB Approach		
Retail - Residential mortgages (incl. securitised mortgages)	1,853	924
Retail - Qualifying revolving retail exposures	3,093	1,999
Retail - Other retail	2,707	2,005
Retail - SME	120	-
Other IRB Approaches		
Corporate - Specialised lending [3]	783	1,947
Equities	39	-
Total	**14,070**	**13,786**
Impairment losses on standardised portfolios		8,521
Fair value adjustments		(6,527)
Net charge to the income statement (Loans and advances to customers and banks)		**15,780**

[1] In order to provide a relevant comparison, gross expected losses as at 31 December 2008 are presented on a 'combined businesses' basis and are therefore inclusive of amounts in relation to the heritage HBOS business.

[2] Impairment losses exclude amounts in relation to debt securities.

[3] During the year Standardised specialised lending portfolios in relation to the Group's North American operations were rolled out onto the supervisory slotting approach. Expected losses in relation to these portfolios are not therefore included in expected losses total as at 31 December 2008.

Accounting policies in relation to the impairment of loans and receivables and factors impacting loss experience during the year to 31 December 2009 are provided within the Past Due Exposures, Impaired Exposures and Impairment Provisions section of the document.

It has not been considered appropriate at present to provide further comparison of model estimates at the start of the year in respect of heritage credit portfolio PDs, LGDs and EADs to actual outcomes of the Group during the year for the reasons set out in the foreword to this document (p.4) on the provision of prior year comparatives.

Validation of model parameters and outputs forms part of the control framework surrounding the development and monitoring of Advanced and Foundation IRB models described on pages 42 to 43.

EXPOSURES SUBJECT TO THE STANDARDISED APPROACH

As at 31 December 2009, credit risk exposures risk weighted under the Standardised Approach amounted to £195.3bn, generating risk weighted assets of £145.5bn and a capital requirement of £11.6bn.

The Group has elected, in the main, not to make use of credit assessments by external credit assessment institutions in determining the risk weights to be applied to credit risk exposures subject to the Standardised Approach. Application of standardised risk weights to these credit risk exposures has therefore been made in line with the BIPRU requirements surrounding unrated exposures.

The following tables indicate the risk weights applied to credit risk exposures subject to the Standardised Approach, by Standardised exposure class, together with the associated RWA. The risk weight is applied to the exposure after consideration of any eligible forms of credit risk mitigation.

Central Governments and Central Banks

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	35,275	-	35,275	-
100%	68	-	68	68
150%	10	-	10	15
Total	**35,353**	**-**	**35,353**	**83**

Regional Governments and Local Authorities

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
20%	71	-	71	14
100%	11	-	11	11
Total	**82**	**-**	**82**	**25**

Administrative Bodies and Non-Commercial Undertakings

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
20%	63	-	63	13
100%	310	-	310	310
Total	**373**	**-**	**373**	**323**

Institutions

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	44	-	44	-
20%	392	-	392	79
50%	144	-	144	72
100%	82	-	82	82
150%	6	-	6	9
Total	**668**	**-**	**668**	**242**

Corporates

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	2,165	-	2,165	-
20%	1,136	-	1,136	227
50%	14	-	14	7
100%	52,531	(232)	52,299	52,299
150%	134	-	134	201
Total	**55,980**	**(232)**	**55,748**	**52,734**

Exposures to corporates amounting to £932m are covered by eligible financial collateral, allowing a risk weight of 0% to be applied. This collateral has not been used to reduce the exposures recognised for risk weighting purposes.

Exposures to corporates amounting to £171m are covered by an export credits guarantee from the UK Export Credit Agency. A risk weight of 0% has been applied to these exposures.

A further £39m of exposures to corporates are covered by guarantees that allow a reduced risk weight to be applied.

Retail

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	1	-	1	-
20%	88	-	88	17
75%	7,417	(80)	7,337	5,503
100%	2,639	(84)	2,555	2,555
150%	7	-	7	10
Total	**10,152**	**(164)**	**9,988**	**8,085**

Retail exposures amounting to £93m are covered by guarantees that allow a reduced risk weight to be applied.

Secured on Real Estate Property

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	143	-	143	-
20%	3	-	3	1
35%	10,200	-	10,200	3,570
50%	1,666	-	1,666	833
75%	3,262	-	3,262	2,447
100%	29,912	(52)	29,860	29,860
150%	1,773	-	1,773	2,660
Total	**46,959**	**(52)**	**46,907**	**39,371**

Exposures secured on real estate property amounting to £143m are covered by a guarantee provided through a Dutch Government scheme. A risk weight of 0% has been applied to these exposures.

Exposures secured on real estate property amounting to £3m are subject to an insurance arrangement which allows the application of a lower risk weighting of 20%.

A further £2m of exposures secured on real estate property are covered by eligible financial collateral, allowing a reduced risk weight to be applied. This collateral has not been used to reduce the exposures recognised for risk weighting purposes.

Past Due Items

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	11	-	11	-
20%	54	-	54	11
35%	166	-	166	58
50%	18	-	18	9
75%	306	-	306	230
100%	6,934	-	6,934	6,934
150%	4,629	-	4,629	6,944
Total	**12,118**	**-**	**12,118**	**14,186**

Past due items amounting to £3m are subject to an insurance arrangement which allows the application of a lower risk weighting of 20%.

A further £53m of past due items are covered by guarantees that allow a reduced risk weight to be applied.

Items Belonging to Regulatory High Risk Categories

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
100%	2	-	2	2
150%	126	-	126	189
370%	1,048	-	1,048	3,878
Deduction from capital	21	-	21	-
Total	**1,197**	**-**	**1,197**	**4,069**

Short Term Claims on Institutions or Corporates

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
100%	632	-	632	632
Total	**632**	**-**	**632**	**632**

Other Items

Risk Weight	Credit Risk Exposure (Pre CRM) £m	Credit Risk Mitigation £m	Credit Risk Exposure (Post CRM) £m	Risk Weighted Asset £m
0%	3,827	-	3,827	-
20%	2,103	-	2,103	421
50%	186	-	186	93
100%	24,664	-	24,664	24,664
Total	**30,780**	**-**	**30,780**	**25,178**

Further details on securitisation exposures subject to the Standardised Approach, including any credit risk mitigation applied, can be found within the Securitisations section of the document.

NON-TRADING BOOK EXPOSURES IN EQUITIES

Non-trading book exposures in equities held by the Group primarily arise within Wholesale Division from individual transactions in the private equity market. These are generally medium to long term investments, held for gain and include venture capital investments, private equity investments and listed and unlisted equity shares.

Private equity investments are managed, and evaluated, in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

Equity exposures in the non-trading book are predominantly accounted for as available for sale financial assets with the remainder recorded at fair value through the income statement. The accounting techniques and valuation methodologies applied are set out within the Group's accounting policies, an extract of which is provided below for reference.

Available-for-sale financial assets

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

The Group is permitted to transfer, at fair value at the date of transfer, a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. For assets transferred, gains or losses recognised in equity in respect of these assets as at the date of transfer are amortised to profit or loss over the remaining life of the asset using the effective interest method.

Venture capital investments

Investments in venture capital activities comprise interests in funds and unlisted equity investments that are valued using techniques that are considered appropriate for that investment. Interests in funds are valued in the same manner as investments in the life funds.

Valuations of unlisted venture capital equities that are accounted for as trading and other financial assets at fair value through profit or loss are calculated using International Private Equity and Venture Capital Guidelines. The majority of investments are valued using the industry standard earnings model. This involves applying the relevant earnings multiple to the maintainable earnings of the business being valued. A number of earnings multiples are used in valuing the portfolio including price earnings, earnings before interest and tax and earnings before interest, tax, depreciation and amortisation. The particular multiple selected being appropriate for the type of business being valued and is derived by reference to the current market-based multiple. Consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple. Another valuation technique involved, although rarely, is the discounting of projected cash flows at the appropriate cost of capital.

Equity investments

Unlisted equities and funds accounted for as available-for-sale assets are valued using different techniques as a result of the variety of investments across the portfolio. A valuation technique is selected for each investment in accordance with the Group’s valuation policy. Depending on the business sector and the circumstances of the investment unlisted equity valuations are based on earnings multiples, net asset values or discounted cash flows.

– The earnings multiple methodology is described in the section on venture capital investments above.

– Valuations using net asset values are often used for property-based businesses and use the latest valuations included in management or statutory accounts adjusted for subsequent movements in property valuations and other factors including recoverability.

– Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return.

For fund investments the most recent capital account value calculated by the fund manager is used as the basis for the valuation and adjusted, if necessary, to align valuation techniques with the Group’s valuation policy.

Accounting policies in relation to the recognition of impairment losses on available-for-sale financial assets are set out on p.36.

The balance sheet value of non-trading book exposures in equities, as at 31 December 2009, is presented in the table below. There was no difference between the balance sheet value and the fair value of these exposures.

Equity Grouping	Balance Sheet Value £m
Publicly quoted equities	149
Privately held equities	2,417
Total	**2,566**

Realised gains recognised in the year to 31 December 2009 in respect of the sale and liquidation of non-trading book exposures in equities amounted to £99m.

As at 31 December 2009, net unrealised gains on available-for-sale equities amounted to £221m. This gain has been included within tier 2 capital.

SECURITISATIONS

The Group is an active participant in the securitisation market, operating as an originator, sponsor and investor. The Group undertakes securitisation activities for a number of reasons, including to manage risk concentrations in its own book, to support relationships with customers and to manage its liquidity and capital positions.

As at 31 December 2009, credit risk exposures classed as securitisations amounted to £128.5bn. An analysis of these exposures by type and risk weight approach, together with the associated capital requirement, is provided in the table below. In addition, the table provides an analysis of further securitisation positions which have been deducted from capital.

Securitisation type and risk weight approach	Credit risk exposure [1] £m	Risk weighted assets [2] £m	Capital requirement £m	Deduction from capital £m
Originated:				
Retail IRB Approach	58,661	10,731	858	-
Ratings Based Approach	6,335	851	68	164
Standardised Approach	749	498	40	10
Supervisory Formula Approach	-	-	-	18
	65,745	**12,080**	**966**	**192**
Sponsored:				
Internal Assessment Approach	12,477	2,158	173	7
Ratings Based Approach [3]	11,248	124	10	102
Standardised Approach	222	60	5	-
	23,947	**2,342**	**188**	**109**
Invested:				
Ratings Based Approach	38,822	4,695	375	337
	38,822	**4,695**	**375**	**337**

[1] Credit risk exposures are disclosed after the application of value adjustments and exclude amounts deducted from capital.

[2] Risk weighted assets reflect the impact of acquisition related fair value adjustments, where applicable.

[3] Sponsored securitisations, where capital requirements are determined under the Ratings Based Approach, have been treated as invested securitisations for the purposes of the analysis provided within this section. An explanation of this treatment is provided on p.64.

The Group utilises the ratings services of several ECAIs, including Standard & Poor's, Moody's and Fitch, to rate securitisation transactions for risk weight allocation purposes where required.

ORIGINATED SECURITISATIONS

As an originator, the Group makes use of securitisation as a means of actively managing its balance sheet. Although there may be regulatory capital benefits from the use of securitisation, the primary objective is funding.

Summary of accounting policies

Originated securitisation transactions typically involve the sale of a group or portfolio of ring fenced loans to another entity, often known as a special purpose entity ('SPE'). An SPE is a purposely created company within a group of companies where the ultimate holding company of the group is unrelated to the originator and is usually held by a trust, meaning Lloyds Banking Group does not legally own the SPE. The Group does, however, administer the SPE and the originating Group company receives fees from the SPE for continuing to service the loans. To raise funds for the purchase (being initially equal to the face value of the assets) fixed and floating rate notes are issued to investors in the financial market from the issuing company within the SPE group of companies. Cash received from the underlying assets is directed towards repaying the loan note holders.

From an accounting perspective, the treatment of SPEs is assessed in accordance with the Standing Interpretations Committee's interpretation (SIC 12) of International Accounting Standard (IAS) 27. This requires SPEs to be consolidated where the substance of the relationship between the Group and the SPE indicates that the SPE is controlled by the Group.

Where the transfer of the Group's assets to the SPE fails the 'derecognition' accounting tests under IAS 39, a deemed loan is reflected in both the Group and SPE accounts for the consideration paid. The transferred assets remain on the Group's balance sheet for accounting purposes. These assets are classified as loans and receivables on the balance sheet and the notes issued (excluding those held by the Group) classified as debt securities in issue. The assets and notes issued are held at amortised cost.

Securitised assets are only derecognised where the following conditions are met:

- substantially all of the risks and rewards associated with the assets have been transferred in which case they are derecognised in full; or

- a significant proportion but not all of the risks and rewards have been transferred, in which case the assets are either derecognised in full where the transferee has the ability to sell the assets, or continue to be recognised by the Group but only to the extent of its continuing involvement; or

- a fully proportional share of all or of specifically identified cash flows have been transferred, in which case that proportion of the assets are derecognised.

A securitisation transaction is recognised as a sale where derecognition is achieved. The difference between the carrying amount and the consideration received is recorded in the income statement.

The Group's securitised residential mortgage assets are not derecognised because the Group remains exposed to the majority of the risk of any default in respect of them. In addition securitised commercial banking loans are not derecognised because the Group has not transferred the contractual rights to receive the cash flows from those loans nor has it assumed a contractual obligation to pay the cash flows from those loans to a third party.

Retained interests are valued in accordance with the accounting policies set out within the 2009 Lloyds Banking Group plc Annual Report and Accounts.

Synthetic securitisations, where credit derivatives are used to transfer the economic risk of the underlying assets but the Group retains legal ownership of the assets, are accounted for under similar accounting policies to those summarised above, with the associated credit derivatives accounted for under the requirements of IAS 39.

Securitisation programmes and activity during the year

The Group’s principal originated securitisation programmes, together with details on the types of loan securitised, the gross assets securitised and the carrying value of the notes in issue at 31 December 2009 are presented on p.172 of the 2009 Lloyds Banking Group plc Annual Report and Accounts. Gross assets securitised increased by £145.0bn during the year, primarily as a result of inheriting a number of securitisation programmes following the acquisition of HBOS plc and the establishment of several new securitisation programmes. Notes in issue at year end amounted to £37.6bn, excluding amounts held by the Group.

Gross securitised exposure

As at 31 December 2009, gross securitised exposures, where the associated notes in issue were held primarily by external market participants rather than by the Group, amounted to £67.0bn comprising both traditional and synthetic originated securitisations. An analysis is provided in the table below together with the amount of impaired exposures and past due but not impaired exposures.

Gross Securitised Exposure

	Traditional £m	Synthetic £m	Impaired exposures [1] £m	Past due but not impaired exposures £m
Residential mortgages	58,812	-	902	1,129
Commercial, auto and other loans	875	7,318	131	95
Total	**59,687**	**7,318**	**1,033**	**1,224**

[1] The net charge to the income statement in respect of losses on residential mortgage securitisations amounted to £51m.

Regulatory treatment

In deriving credit risk exposures associated with originated securitisations, the Group takes into account that certain securitised assets, whilst held on the balance sheet for accounting purposes, are deemed to have met the prudential significant risk transfer tests when securitised and therefore the retained position in the securitisation is included within regulatory calculations rather than the underlying assets.

Capital requirements in relation to originated securitisation credit risk exposures are determined under either one of the IRB Approach methodologies or under the Standardised Approach.

Originated securitisations subject to the Retail IRB Approach

Securitised residential mortgage exposures subject to the IRB Approach are risk weighted on the basis of the underlying exposures where no significant risk transfer has occurred. This is also referred to as a 'look through' basis. These exposures relate to assets held through the Group's residential mortgage securitisation programmes as noted previously.

As at 31 December 2009, capital requirements in respect of these exposures amounted to £858m, based on an RWA of £10.7bn. Further detail on these exposures, analysed by PD Grade, is provided in the table below.

Securitised Residential Mortgage exposures by PD Grade

PD Grade	Credit Risk Exposure	Exposure Weighted Average PD	Exposure Weighted Average LGD	Average Risk Weight	Risk Weighted Asset
	£m	%	%	%	£m
0	25,579	0.06%	10.96%	1.87%	479
1	17,410	0.30%	16.97%	9.83%	1,711
2	6,069	0.75%	21.16%	23.69%	1,439
3	882	0.98%	14.03%	18.38%	162
4	3,906	1.64%	27.24%	49.44%	1,931
5	1,135	3.24%	25.05%	67.73%	769
6	1,332	6.08%	29.91%	114.39%	1,523
7	632	10.27%	26.44%	128.15%	810
8	175	11.96%	11.94%	61.43%	108
9	132	16.41%	12.98%	73.65%	97
10	217	25.31%	21.05%	128.67%	279
11	196	39.43%	18.08%	105.98%	208
12	296	67.05%	17.87%	68.17%	202
Default	700	100.00%	12.54%	144.85%	1,013
Total	**58,661**	**2.46%**	**15.92%**	**18.29%**	**10,731**

Originated securitisations subject to the Ratings Based Approach

Retained positions in certain originated synthetic securitisations are risk weighted under the Ratings Based Approach. This approach utilises a set of defined risk weights prescribed by the FSA. The appropriate risk weighting is dependent on factors such as maturity and seniority of the position together with the granularity of the asset pool backing the position.

As at 31 December 2009, originated securitisation exposures risk weighted under the Ratings Based Approach amounted to £6.5bn, generating a capital requirement of £68m.

Senior Positions

S&P Equivalent Rating and RBA Risk Weight	Exposure £m
Super Senior Positions: 6%	3,199
AA: 8%	2,518
Total	**5,717**

Non-Senior Positions

S&P Equivalent Rating and RBA Risk Weight	Exposure £m
AAA: 12%	196
AA: 15%	181
A+: 18%	55
A-: 35%	94
BBB: 75%	57
BBB-: 100%	12
BB+: 250%	14
BB: 425%	9
Below BB- / Unrated: Deduction	164
Total	**782**

TOTAL

S&P Equivalent Rating	Exposure £m
Super Senior Positions	3,199
AAA	196
AA	2,699
A+	55
A-	94
BBB	57
BBB-	12
BB+	14
BB	9
Below BB- / Unrated: Deduction	164
Total [1]	**6,499**
Value adjustments taken to reserves	-
Deduction from capital	(164)
Total Credit Risk Exposure	**6,335**

[1] The total exposure is defined as the gross nominal amount.

Originated securitisations subject to the Standardised Approach

As at 31 December 2009, credit risk exposures associated with originated securitisations amounting to £749m were risk weighted under the Standardised Approach to credit risk, generating an RWA of £498m and a capital requirement of £40m.

An analysis of these exposures by risk weight is provided in the table below.

Risk Weight %	Credit Risk Exposure £m	Risk Weighted Asset £m	Capital Requirement £m	Deduction from Capital £m
0%	248	-	-	-
35%	29	10	1	-
75%	11	8	1	-
100%	453	453	36	-
350%	8	27	2	-
Deduction	-	-	-	10
Total	**749**	**498**	**40**	**10**

Credit risk exposures risk weighted at 0% relate to the underlying exposures of the Candide 3 securitisation programme. As no significant risk has been transferred, the underlying exposures are risk weighted on a 'look through' basis in accordance with Standardised Approach risk weighting requirements relevant to the exposure class. However, as the underlying exposures are covered by a guarantee from the Dutch Government a 0% risk weight has been applied.

For the Candide 1 and 2 securitisation programmes, risk weight bands based on the use of an ECAI (Moody's) have been applied, resulting in a risk weight of 350% applied to £8m of the retained position, with a further £10m categorised as '350% and below or unrated' and therefore deducted from capital.

Credit risk exposures risk weighted at 100% relate primarily to the underlying exposures of the Bella securitisation programme. As no significant risk has been transferred, the underlying exposures are risk weighted on a 'look through' basis in accordance with Standardised Approach risk weighting requirements relevant to the exposure class.

Originated securitisations subject to the Supervisory Formula Approach

As at 31 December 2009, aggregate retained positions in relation to the Prominent securitisation programme amounting to £18m were deducted from capital. The positions relate entirely to reserve accounts.

SPONSORED SECURITISATIONS

The Group sponsors three asset backed commercial paper conduits, Cancara, Grampian and Landale which invest in debt securities and client receivables. These are a series of bankruptcy remote SPE's that purchase asset backed securities and are funded by the issue of asset backed commercial paper or through banking facilities. Each of the conduits consists of a central funding company that issues external funding and lends to purchasing companies.

Through Cancara, the Group provides funding via securitisation facilities for the Group's core corporate and financial institution clients.

Grampian was established for investment purposes to benefit from the margin between the assets purchased and the notes issued. Landale was also established for investment purposes, though on the basis of client and own debt origination.

All the external assets in these conduits are consolidated for accounting purposes in the Group's financial statements, following similar accounting policies to those established for originated securitisations. Debt securities in relation to Grampian and Landale are classified as loans and receivables and held at amortised cost. The majority of debt securities in relation to Cancara are classified as available-for-sale. Further details on the consolidated accounting exposures in these conduits are presented on p.173 of the 2009 Lloyds Banking Group plc Annual Report and Accounts. The increase in total assets during the year was due to the inclusion of Grampian and Landale following the acquisition of HBOS plc.

In relation to Grampian and the majority of Landale, capital requirements are determined by 'looking through' to the underlying asset portfolios within the conduits and not therefore in respect of the liquidity facilities provided. As a result of this approach, exposures to the underlying asset portfolios of the conduits are treated as invested securitisation exposures, with capital requirements calculated under the Ratings Based Approach. As at 31 December 2009, the total credit risk exposure in respect of the underlying asset portfolios amounted to £11.2bn, further analysis of which is provided within the invested securitisation section.

Remaining capital requirements in relation to Landale are calculated under the Standardised Approach and relate to a position in a sponsored vehicle funded by Landale. As at 31 December 2009, the total credit risk exposure in respect of this position amounted to £222m. An analysis, by risk weight under the Standardised Approach, is provided in the table below.

Risk Weight %	Credit Risk Exposure £m	Risk Weighted Asset £m	Capital Requirement £m	Deduction from Capital £m
20%	202	40	3	-
100%	20	20	2	-
Total	**222**	**60**	**5**	**-**

In relation to Cancara, the Group has approval to utilise the Internal Assessment Approach for calculating capital requirements on the basis of the liquidity facilities provided to the conduit. As at 31 December 2009, the total credit risk exposure of the Group in respect of the liquidity facilities provided to Cancara amounted to £12.5bn. An analysis of this exposure, by underlying exposure type, is provided in the table below.

Exposure Type	Exposure £m
Mortgage Backed Securities:	
US RMBS	37
Non-US RMBS	3,402
CMBS	1,380
Collateralised Debt Obligations:	
CLO	1,354
Personal Sector:	
Auto Loans	1,597
Credit Cards	480
FFELP Student Loans	223
Trade receivables	1,739
Other ABS	2,272
Total [1]	**12,484**
Value adjustments taken to reserves	-
Deduction from capital	(7)
Total Credit Risk Exposure	**12,477**

[1] The total exposure is defined as the gross nominal amount.

An analysis of the total credit risk exposure by risk weight category under the Internal Assessment Approach is provided in the table below.

S&P Equivalent Rating and IAA Risk Weight	Exposure £m
AAA: 7%	4,013
AA: 8%	4,718
A+: 10%	910
A: 12%	583
A-: 20%	786
BBB: 60%	893
BBB-: 100%	574
Below BB- / Unrated: Deduction	7
Total	**12,484**
Value adjustments taken to reserves	-
Deduction from capital	(7)
Total Credit Risk Exposure	**12,477**

INVESTED SECURITISATIONS

In addition to sponsoring asset backed commercial paper conduits, the Group invests directly in asset backed securities. These transactions are primarily used as part of the Group's liquidity asset portfolio.

The majority of these investments are accounted for as loans and receivables on the balance sheet and held at amortised cost, with the remainder held as available-for-sale or at fair value through the income statement.

The Group's invested securitisation exposures comprise of these direct investments in asset backed securities, together with the underlying assets of the Group's sponsored asset backed commercial paper conduits, Grampian and Landale. Further details on the Group's net exposure to asset backed securities are presented on p.238 of the 2009 Lloyds Banking Group plc Annual Report and Accounts. The increase in the net exposure to asset backed securities during the year was primarily due to the inclusion of net exposures to asset backed securities following the acquisition of HBOS plc.

An analysis of invested securitisation exposures as at 31 December 2009, by exposure type, is provided in the table below.

Exposure Type	Exposure £m
Mortgage Backed Securities:	
US RMBS	8,929
Non-US RMBS	9,031
CMBS	6,527
Collateralised Debt Obligations:	
CLO	7,294
Other	2,323
Personal Sector:	
Auto Loans	1,732
Credit Cards	3,740
Personal Loans	860
FFELP Student Loans	10,308
Other ABS	3,566
Total [1]	**54,310**
Value adjustments taken to reserves	(3,801)
Deduction from capital	(439)
Total Credit Risk Exposure [2]	**50,070**

[1] The total exposure is defined as the gross nominal amount.

[2] The total credit risk exposure comprises £38,822m in relation to direct investments in asset backed securities and £11,248m in relation to the underlying assets of Grampian and Landale.

Capital requirements in relation to invested securitisation exposures are calculated in accordance with the Ratings Based Approach. This approach utilises a set of defined risk weights prescribed by the FSA. The appropriate risk weighting is dependent on factors such as maturity and seniority of the position together with the granularity of the asset pool backing the position.

An analysis of invested securitisation exposures by risk weight category under the Ratings Based Approach is provided in the tables below.

Senior Positions

S&P Equivalent Rating and RBA Risk Weight	Exposure £m
Super Senior Positions: 6%	82
AAA: 7%	32,804
AA: 8%	2,918
A+: 10%	611
A: 12%	934
A-: 20%	565
BBB+: 35%	394
BBB: 60%	128
BBB-: 100%	133
BB+: 250%	465
BB: 425%	147
Below BB- Unrated: Deduction	1,463
Total	**40,644**

Non-Senior Positions

S&P Equivalent Rating and RBA Risk Weight	Exposure £m
AAA: 12%	699
AA: 15%	1,283
A+: 18%	384
A: 20%	395
A-: 35%	265
BBB+: 50%	279
BBB: 75%	254
BBB-: 100%	281
BB+: 250%	258
BB: 425%	337
BB-: 650%	248
Below BB- / Unrated: Deduction	2,594
Total	**7,277**

Tranches Backed by Non-Granular Pools

S&P Equivalent Rating and RBA Risk Weight	Exposure £m
AAA: 20%	2,991
AA: 25%	1,493
A+: 35%	90
A: 35%	576
A-: 35%	675
BBB+: 50%	111
BBB: 75%	148
BBB-: 100%	108
BB+: 250%	14
Below BB- / Unrated: Deduction	183
Total	**6,389**

TOTAL

S&P Equivalent Rating	Exposure £m
Super Senior Positions	82
AAA	36,494
AA	5,694
A+	1,085
A	1,905
A-	1,505
BBB+	784
BBB	530
BBB-	522
BB+	737
BB	484
BB-	248
Below BB- / Unrated: Deduction	4,240
Total	**54,310**
Value adjustments taken to reserves	(3,801)
Deduction from capital	(439)
Total Credit Risk Exposure	**50,070**

CREDIT RISK MITIGATION

The Group uses a range of approaches to mitigate credit risk.

INTERNAL CONTROL

Credit principles and policy: group risk sets out the Group credit principles and policy according to which credit risk is managed, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Divisional and business unit policy includes lending guidelines, which define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions.

Counterparty limits: Limits are set against all types of exposure in a counterparty name, in accordance with an agreed methodology for each exposure type. This includes credit risk exposure on individual derivative transactions, which incorporates potential future exposures from market movements. Aggregate facility levels by counterparty are set and limit breaches are subject to escalation procedures.

Credit scoring: In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring). Divisional risk departments review scorecard effectiveness and approve changes, with material changes being subject to group risk approval.

Individual credit assessment and sanction: Credit risk in wholesale portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. The Group's credit risk appetite criteria for counterparty underwriting are the same as that for assets intended to be held over the period to maturity.

Controls over rating systems: The Group has established an independent team in group risk that sets common minimum standards, designed to challenge the discriminatory powers of systems, accuracy of calibration and seeks to ensure consistency over time and across obligors. Internal rating systems are developed and implemented by independent risk functions either in the business units or divisions with the business unit managing directors having ownership of the systems. Line management takes responsibility for ensuring the validation of the respective internal rating systems, supported and challenged by specialist functions in their respective division.

Cross-border and cross-currency exposures: Country limits are authorised by the Country Limits Panel taking into account economic and political factors.

Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite. Credit policy is aligned to the Group's risk appetite and restricts exposure to certain high risk and more vulnerable sectors and segments. Exposures are monitored to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.

Stress testing and scenario analysis: The credit portfolio is also subjected to stress-testing and scenario analysis, to simulate outcomes and calculate their associated impact. Events are modelled at a group wide level, at divisional and business unit level and by rating model and portfolio, for example, for a specific industry sector.

Specialist expertise: Credit quality is maintained by specialist units providing, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector specific expertise; and legal services applicable to the particular market place and product range offered by the business.

Daily settlement limits: Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the Group's market transactions on any single day.

Risk assurance and oversight: Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

COLLATERAL

The principal collateral types for loans and advances are:

- mortgages over residential and commercial real estate;
- charges over business assets such as premises, inventory and accounts receivable;
- charges over financial instruments such as debt securities and equities; and
- guarantees received from third parties.

The Group maintains guidelines on the acceptability of specific classes of collateral.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, except where securities are held as part of reverse repurchase or securities borrowing transactions or where a collateral agreement has been entered into under a master netting agreement. Collateral or other security is also not usually obtained for credit risk exposures on derivative instruments, except where the Group requires margin deposits from counterparties.

It is the Group's policy that collateral should always be realistically valued by an appropriately qualified source, independent of the customer, at the time of borrowing. Collateral is reviewed on a regular basis in accordance with business unit credit policy, which will vary according to the type of lending and collateral involved. In order to minimise the credit loss, the Group may seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances.

The Group considers risk concentrations by collateral providers and collateral type, as appropriate, with a view to ensuring that any potential undue concentrations of risk are identified and suitably managed by changes to strategy, policy and / or business plans.

MASTER NETTING AGREEMENTS

Where it is efficient and likely to be effective (generally with counterparties with which it undertakes a significant volume of transactions), the Group enters into master netting agreements. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis, they do reduce the credit risk to the extent that, if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting agreements can change substantially within a short period since it is affected by each transaction subject to the agreement.

OTHER CREDIT RISK TRANSFERS

The Group also undertakes asset sales, securitisations and credit derivative based transactions as a means of mitigating or reducing credit risk, taking into account the nature of assets and the prevailing market conditions.

GUARANTEES

A guarantee is a contract whereby the surety (the guarantor) promises the creditor in the event of failure to pay by the obligor to be responsible, in addition to the obligor, for the due performance of particular obligations to the creditor if the obligor fails to perform those obligations. Regulatory capital relief is only taken through the use of PD substitution for guarantees provided by appropriate sovereigns and institutions.

CREDIT DERIVATIVES

Credit derivatives are a method of transferring credit risk from one counterparty (the protection buyer) to another (the protection seller). In return for a risk premium, the protection seller agrees to make a payment (or series of payments) to the protection buyer in the event of the occurrence of a stipulated event. Further details are included within the Counterparty Credit Risk section of the document.

EXPOSURES COVERED BY ELIGIBLE COLLATERAL, GUARANTEES AND CREDIT DERIVATIVES

Where an exposure subject to the IRB Approach is covered by a form of credit risk mitigation, this can result in an adjustment to either the PD, LGD or EAD of the exposure. For example, guarantees can influence the estimated PD, whilst financial collateral such as cash can result in an adjustment to the LGD.

Where eligible collateral applies in respect of credit risk exposures subject to the Advanced IRB Approach, the LGD component of the relevant model is adjusted to reflect its impact. An analysis of exposure weighted average LGDs by PD Grade in respect of credit risk exposures subject to the Advanced IRB Approach is presented on pages 45 to 46. This analysis incorporates the application of any eligible collateral employed.

The use of credit risk mitigation in relation to counterparty credit risk exposures is discussed within the Counterparty Credit Risk section of the document.

The following table provides an analysis of Foundation IRB and Standardised credit risk exposures covered by eligible financial collateral or other financial collateral and an analysis of Advanced IRB, Foundation IRB and Standardised credit risk exposures covered by guarantees or credit derivatives. The analysis excludes exposures covered by eligible financial collateral, other eligible collateral, guarantees or credit derivatives that are not taken into consideration in the calculation of credit risk capital requirements.

	Exposures covered by eligible financial collateral	Exposures covered by other eligible collateral	Exposures covered by guarantees	Exposures covered by credit derivatives	TOTAL
	£m	£m	£m	£m	£m
Exposures subject to the IRB Approach					
Advanced IRB Approach					
Corporate - Main			10	-	**10**
Corporate - SME			103	-	**103**
Central governments and central banks			-	-	**-**
Institutions			-	840	**840**
Foundation IRB Approach					
Corporate - Main	6,087	3,133	351	270	**9,841**
Corporate - SME	17	-	-	-	**17**
Corporate - Specialised lending	48	-	-	-	**48**
Central governments and central banks	-	-	641	-	**641**
Institutions	2,643	4,226	1,020	1,273	**9,162**
Retail IRB Approach					
Retail - Residential mortgages	-	-	-	-	-
Retail - Originated, securitised residential mortgages	-	-	-	-	-
Retail - Qualifying revolving retail exposures	-	-	-	-	-
Retail - Other retail	-	-	40	-	**40**
Retail - SME	-	-	-	-	-
Other IRB Approach					
Corporate - Specialised lending	103	-	-	-	**103**
Equities - Exchange traded	-	-	-	-	-
Equities - Private equity	-	-	-	-	-
Equities - Other	-	-	-	-	-
Securitisations positions	-	-	-	-	-
Total - IRB Approach	**8,898**	**7,359**	**2,165**	**2,383**	**20,805**
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	-	-	**-**
Regional governments or local authorities	-	-	-	-	**-**
Administrative bodies and non-commercial undertakings	-	-	-	-	**-**
Institutions	-	-	-	-	**-**
Corporates	1,164	-	210	-	**1,374**
Retail	164	-	93	-	**257**
Secured on real estate property	54	-	146	-	**200**
Past due items	-	-	56	-	**56**
Items belonging to regulatory high risk categories	-	-	-	-	**-**
Securitisation positions	-	-	248	-	**248**
Short term claims on institutions or corporates	-	-	-	-	**-**
Total - Standardised Approach	**1,382**	**-**	**753**	**-**	**2,135**
TOTAL	**10,280**	**7,359**	**2,918**	**2,383**	**22,940**

The impact of the above eligible financial collateral and guarantees on the exposures risk weighted under the Standardised Approach is disclosed on pages 54 to 56.

Further details on collateral held against retail mortgage lending, including the fair value of collateral held in respect of retail mortgage loans which are past due but not impaired and an analysis of repossessed collateral can be found in the Notes to the Consolidated Financial Statements, 2009 Lloyds Banking Group plc Annual Report and Accounts, pages 234 to 235.

COUNTERPARTY CREDIT RISK

Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and may include derivative contracts and repo contracts.

INTERNAL CAPITAL AND CREDIT LIMITS

The maximum credit risk appetite for counterparties is determined through a combination of credit quality (expressed as an internal credit rating) and size (measured by its capital and reserves). In general, activity of the Group is conducted with counterparties that have internal credit ratings equivalent to investment grade as measured by external credit rating agencies.

Internal credit ratings are mapped to statistically derived PDs, which when combined with LGDs and EADs determine EL. To calculate EAD, values for derivative products are determined by using the mark-to-market methodology for regulatory purposes and internally developed models for limit management. EL is then used to calculate the minimum capital from which the RWA is derived.

SECURING COLLATERAL AND ESTABLISHING CREDIT RESERVES

Use is made of collateral and risk mitigation techniques to reduce credit risks in various portfolios. These include the use of collateral (principally cash, government securities and guarantees), break clauses and netting. In addition, a gross notional control for repo and stock borrowing exists. Policy is set governing types of acceptable collateral and haircuts, in line with industry norms.

Collateral arrangements are governed by standard agreements (such as Global Master Repurchase Agreements and Credit Support Annexes to ISDA Master Agreements). To recognise the effects of credit risk mitigation, any agreements must be valid, enforceable, unconditional and irrevocable. In addition, collateral must be transferred to the Bank through the passing of title and should be netable on a portfolio basis. Once these conditions are met, the effect of collateral received is reflected in reductions to all applicable credit exposures and in capital adequacy calculations.

Collateral received is reviewed daily to ensure quality is maintained and concentrations are avoided as necessary.

CORRELATION RISK

Credit policies are formed to avoid correlation or wrong way risk. Under the repo policies, the issuer of the collateral and the counterparty should be neither the same nor connected. The same rule applies for derivatives under collateral policies. The credit departments have the necessary discretion to extend this rule to other cases where there is significant correlation.

COLLATERAL REQUIREMENTS IN THE EVENT OF A DOWNGRADE IN CREDIT RATING

A significant increase in the level of collateral to be posted in the event of a downgrade to the Lloyds Banking Group (or an entity within the Group) could only arise if a number of Collateral agreements have been written allowing this. It is both policy and practice for the ISDA Credit Support Annexes to require all exposures to be fully collateralised from the outset, irrespective of the Group's ratings. Therefore as there are very few documents with such downgrade triggers the impact of additional collateral requirements is not meaningful.

CREDIT VALUATION ADJUSTMENTS

Details on the application of credit value adjustments ('CVA') within the Group are provided on p.228 of the 2009 Lloyds Banking Group plc Annual Report and Accounts.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY MEASUREMENT APPROACH

The credit risk exposure value in respect of counterparty credit risk as at 31 December 2009 was £48.7bn. An analysis by measurement approach is presented in the table below.

	Credit Risk Exposure £m
CCR Standardised Approach	-
CCR Mark to Market Method	48,716
CCR Internal Model Method	-
Total	**48,716**

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY CONTRACT TYPE

An analysis of counterparty credit risk exposures as at 31 December 2009, by contract type, is presented in the table below.

	Credit Risk Exposure £m
Interest rate contracts	36,477
Foreign exchange contracts	2,978
Equity contracts	543
Credit derivatives	853
Commodity contracts	1,086
Repo contracts	6,779
Total	**48,716**

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY RISK WEIGHT APPROACH

An analysis of counterparty credit risk exposures and RWAs as at 31 December 2009, by risk weight approach, is presented in the table below.

	Credit Risk Exposure £m	Risk Weighted Assets £m
Standardised Approach	6,755	6,553
IRB Approach	41,961	5,692
Total	**48,716**	**12,245**

NET DERIVATIVES CREDIT EXPOSURE

The gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held, net potential future credit exposure ('PFE') and resultant 'net derivatives credit exposure', as at 31 December 2009, are presented separately in the table below.

	£m
Gross positive fair value of contracts	50,395
Netting benefits	(29,853)
Netted current credit exposure	20,542
Net potential future credit exposure	8,434
Collateral held	(3,888)
Total Net Derivatives Credit Exposure	**25,088**

Collateral held primarily relates to cash and government securities.

NOTIONAL VALUE OF CREDIT DERIVATIVE TRANSACTIONS

The notional value of credit derivative transactions outstanding at 31 December 2009 was £19.7bn, an analysis of which is presented in the table below. These transactions relate entirely to credit default swaps.

	Notional Value £m
Own credit portfolio – protection bought	14,391
Own credit portfolio – protection sold	5,282
Total	**19,673**

MARKET RISK

DEFINITION

The risk of reductions in earnings, value and / or reserves, through financial or reputational loss, arising from unexpected changes in financial prices, including interest rates, inflation rates, exchange rates, credit spreads and prices for bonds, commodities, equities, property and other instruments. It arises in all areas of the Group's activities and is managed by a variety of different techniques.

RISK APPETITE

Market risk appetite is defined with regard to the quantum and composition of market risk that exists currently in the Group and the direction in which the Group wishes to manage this.

This statement of the Group's overall appetite for market risk is reviewed and approved annually by the board. With the support of the group asset and liability committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

The Group's banking activities expose it to the risk of adverse movements in interest rates, credit spreads, exchange rates and equity prices, with little or no exposure to commodity risk. The volatility of market values can be affected by both the transparency of prices and the amount of liquidity in the market for the relevant asset.

Most of the Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange and interest rate products. However, some interest rate, exchange rate and credit spread positions are taken using derivatives and other on-balance sheet instruments with the objective of earning a profit from favourable movements in market rates.

Market risk in the Group's retail portfolios and in the Group's capital and funding activities arises from the different repricing characteristics of the Group's non-trading assets and liabilities. Interest rate risk arises predominantly from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets.

Foreign currency risk also arises from the Group's investment in its overseas operations.

The Group's insurance activities also expose it to market risk, encompassing interest rate, exchange rate, property, credit spreads and equity risk:

– With Profit Funds are managed with the aim of generating rates of return consistent with policyholders' expectations and this involves the mismatch of assets and liabilities.

– Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets.

– For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result, the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch.

– Surplus assets are held primarily in four portfolios: (a) in the long term funds of Scottish Widows plc, Clerical Medical Investment Group Limited and their subsidiaries; (b) in the shareholder funds of life assurance companies; (c) investment portfolios within the general insurance business and (d) within the main fund of Heidelberger Lebensversicherung AG.

The Group's defined benefit staff pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily equity and real interest rate risk.

MEASUREMENT

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. This is used for determining the Group's overall market risk appetite and for the high level allocation of risk appetite across the Group.

Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. In addition, the use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. Where VaR models are less well suited to the nature of positions, the Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity, and include interest rate repricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at group level, to simulate extreme conditions to supplement these core measures.

The Group's VaR Model permissions allow it to calculate the Group's Pillar 1 market risk capital requirement for the trading book using VaR models. These models are used by the Group for internal risk measurement of the trading book. The VaR Model permissions across both LTSB and HBOS heritages cover general interest rate, specific interest rate, foreign exchange and equity asset classes. The capital charge is based on the 10 day 99% VaR calculated by the models.

The Group uses an historical simulation methodology to calculate VaR for the trading book. This methodology consists of calculating historical daily price movements in a full range of market risk factors. The historical daily price movements are applied to positions to create a distribution of hypothetical daily profit and loss scenarios. The hypothetical daily changes in portfolio value are ranked, and the 95th and 99th percentile worst losses are identified. The model incorporates all relevant and significant market risk factors so that the market risk from a full range of trading strategies can be captured accurately. The Group compares daily profit and loss with VaR calculated at a 1 day 99% confidence level on a daily basis. The purpose of this analysis is to provide an indication of how well the VaR model's output, a VaR forecast, has described the corresponding trading outcome. Analysis is performed at the aggregate trading book level, and individual trading desk level. The Group also compares hypothetical profit or loss with the VaR calculated at a 1 day 99% confidence level on a daily basis. Hypothetical profit or loss is the profit or loss that would have resulted assuming that the portfolio remains unchanged from one day to the next.

The Group's trading book stress testing program consists of sensitivity tests, historical scenario tests and hypothetical scenario tests. Sensitivity tests consist of stressing individual market risk factors, such as interest rates and foreign exchange rates, and calculating the resultant loss. Historical scenario tests consist of identifying major stress events that have occurred historically, and calculating the resultant loss from these scenarios reoccurring. Hypothetical scenario tests consist of forecasting major economic events, predicting the resultant impact on financial markets and calculating the losses that would occur from these moves in financial markets. In general, the Group’s trading book stress tests are applied across all asset classes and all trading book portfolios simultaneously in order that diversification and correlation effects are fully captured.

Valuation Principles

The consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards. Trading securities, other financial assets and liabilities at fair value through profit or loss, derivatives and available-for-sale financial assets are stated at fair value. The fair value of these financial instruments is the amount for which an asset could be exchanged or a liability settled between willing parties in arm’s length transactions. The fair values of financial instruments are determined by reference to observable market prices where these are available and the market is active. Where market prices are not available or are unreliable because of poor liquidity, fair values are determined using valuation techniques including cash flow models which, to the extent possible, use observable market parameters. The process of calculating the fair value using valuation techniques may necessitate the estimation of certain pricing parameters, assumptions or model characteristics.

The Group maintains systems and controls sufficient to provide reliable valuation estimates, including documented policies, clearly defined roles and responsibilities and departments accountable for verification that are independent of the front office and report ultimately to a main board director. Where models are used, the assumptions, methodologies, mathematics and software implementation are assessed and challenged by suitably qualified parties independent of the development process.

The Group considers the need for reserves including unearned credit spreads, close-out costs, investing and funding costs. Any material adjustments required by GENPRU 1.3 that are not required by International Financial Reporting Standards are reconciled to the financial statements and reported to the FSA in prudential returns.

Banking – Trading Assets and Other Treasury Positions

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the year ended 31 December 2009 based on the Group’s global trading positions was as detailed in the table below.

	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	12.0	20.2	31.4	11.8
Foreign exchange risk	1.1	1.7	9.3	0.2
Equity Risk	1.8	1.4	3.3	0.0
Credit spread risk	16.7	17.4	21.0	13.6
Total VaR	**31.6**	**40.7**	**53.3**	**31.6**

For the above table the average, minimum and maximum positions reflect the period from 19 January 2009 to 31 December 2009.

The risk of loss measured by the VaR model is the potential loss in earnings given the confidence level and assumptions noted above. The total and average trading VaR does not assume any diversification benefit across the four risk types. VaR is a statistical measure and the trading book exposures for the two independently managed heritage banks, Lloyds TSB and HBOS, arose from different management strategies and were measured against differing risk appetites. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole. The Group internally uses VaR as the primary measure for all treasury positions arising from short term market facing activity, whether trading or banking book. Therefore the numbers above will include some risks which are also included in Banking non-trading, primarily those relating to the funding of lending activities.

Banking – Non-Trading

Market risk in non-trading books consists almost entirely of exposure to changes in interest rates. This is the potential impact on earnings and value that could occur when, if rates fall, liabilities cannot be re-priced as quickly or by as much as assets; or when, if rates rise, assets cannot be re-priced as quickly or by as much as liabilities.

Risk exposure is monitored monthly using, primarily, market value sensitivity. This methodology considers all re-pricing mismatches in the current balance sheet and calculates the change in market value that would result from a set of defined interest rate shocks. Where re-pricing maturity is based on assumptions about customer behaviour these assumptions are also reviewed monthly.

A limit structure exists to ensure that risks stemming from residual and temporary positions or from changes in assumptions about customer behaviour remain within the Group's risk appetite.

The following table shows, split by material currency, Lloyds Banking Group sensitivities as at 31 December 2009 to an immediate up and down 25 basis points change to all interest rates.

	Up 25bps £m	Down 25bps £m
Sterling	66.6	(66.4)
US Dollar	(5.5)	5.6
Euro	4.4	(4.4)
Australian Dollar	2.2	(2.3)
Other	(0.2)	0.2
Total	**67.5**	**(67.3)**

Base case market value is calculated on the basis of the Lloyds Banking Group current balance sheet with re-pricing dates adjusted according to behavioural assumptions. The above sensitivities show how this projected market value would change in response to an immediate parallel shift to all relevant interest rates – market and administered.

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

The measure, however, is simplified in that it assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

Pension Schemes

Management of the assets of the Group's defined benefit pension schemes is the responsibility of the Scheme Trustees, who also appoint the Scheme Actuaries to perform the triennial valuations. The Group monitors its pensions exposure holistically using a variety of metrics including accounting and economic deficits and contribution rates. These and other measures are regularly reviewed by the Pensions Strategy Committee and used in discussions with the Trustees, through whom any risk management and mitigation activity must be conducted.

Insurance Portfolios

The Group's market risk exposure in respect of insurance activities described above is measured using EEV as a proxy for economic value. The pre-tax sensitivity of EEV to standardised stresses is shown below for the year ended 31 December 2009. During 2009, the credit spread sensitivity was changed from a 25 basis point increase to a 30 per cent widening of the spread between corporate bonds and the swap curve, including an allowance for the assumed change in the illiquidity premium. Foreign exchange risk arises predominantly from overseas holdings of equities. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical.

	2009 £m
Equity risk (impact of 10% fall pre-tax)	(383.6)
Interest rate risk (impact of 25 basis point reduction pre-tax)	64.0
Credit spread risk (impact of 30% widening)	(156.4)

MITIGATION

Various mitigation activities are undertaken across the Group to manage portfolios and seek to ensure they remain within approved limits.

Banking – Non-Trading Activities

Interest rate risk arising from the different repricing characteristics of the Group's non-trading assets and liabilities, and from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets, is managed centrally. Matching assets and liabilities are offset against each other and internal interest rate swaps are also used.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

Insurance Activities

Investment holdings are diversified across markets and, within markets, across sectors. Holdings are diversified to minimise specific risk and the relative size of large individual exposures is monitored closely. For assets held outside unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

MONITORING

The group asset and liability committee regularly reviews high level market risk exposure including, but not limited to, the data described above. It also makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy. Exposures at lower levels of delegation are monitored at various intervals according to their volatility, from daily in the case of trading portfolios to monthly or quarterly in the case of less volatile portfolios. Levels of exposures compared to approved limits and triggers are monitored locally by independent risk functions and at a high level by group risk. Where appropriate, escalation procedures are in place.

Banking Activities

Trading is restricted to a small number of specialist centres, the most important centre being the treasury and trading business in London. These centres also manage market risk in the wholesale non-trading portfolios, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the wholesale portfolios is necessary to meet customer requirements and changing market circumstances.

Market risk in the Group's retail portfolios and in the Group's capital and funding activities is managed within a framework of limits and triggers defined in the detailed Group policy for interest rate risk in the banking book, which is reviewed and approved annually.

Insurance Activities

Market risk exposures from the insurance businesses are controlled via approved investment policies and triggers set with reference to the Group's overall risk appetite and regularly reviewed by the group asset and liability committee:

– The With Profit Funds are managed in accordance with the relevant fund's principles and practices of financial management and legal requirements.

– The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match the cash flows.

– Investment strategy for surplus assets held in excess of liabilities takes account of the legal, regulatory and internal business requirements for capital to be held to support the business now and in the future.

The Group also agrees strategies for the overall mix of pension assets with the pension scheme trustees.

MARKET RISK CAPITAL REQUIREMENT

As at 31 December 2009 the capital requirement in respect of market risk in the trading book amounted to £289m.

Approach / Risk	Capital Requirement £m
Internal Models Approach	168
Standardised Approach	
Interest Rate PRR	110
Foreign Exchange Risk	10
Commodity PRR	1
Total	**289**

OPERATIONAL RISK

DEFINITION

The risk of reductions in earnings and / or value, through financial or reputational loss, from inadequate or failed internal processes and systems, operational inefficiencies, or from people related or external events.

There are a number of categories of operational risk:

Legal and regulatory risk

Legal and regulatory risk is the risk of reductions in earnings and / or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

Customer treatment risk

The risk of reductions in earnings and / or value, through financial or reputational loss, from inappropriate or poor customer treatment.

People risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate colleague actions and behaviour, industrial action, legal action in relation to people, or health and safety issues. Loss can also be incurred through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance.

Integration risk

The risk that Lloyds Banking Group fails to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or incurs unanticipated costs and losses associated with, the acquisition of HBOS plc.

Business process risk

The risk of reductions in earnings and / or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events and deficiencies in the performance of external suppliers / service providers.

Financial crime risk

The risk of reductions in earnings and / or value, through financial or reputational loss, associated with financial crime and failure to comply with related legal and regulatory obligations (which includes compliance with economic sanctions), these losses may include censure, fines or the cost of litigation.

Security risk

The risk of reductions in earnings and / or value, through financial or reputational loss, resulting from theft of or damage to the Group's assets, the loss, corruption, misuse or theft of the Group's information assets or threats or actual harm to the Group's people. This also includes risks relating to terrorist acts, other acts of war, geopolitical, pandemic or other such events.

Change risk

The risk of reductions in earnings and / or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale, failing to implement change effectively or failing to realise desired benefits.

Governance risk

The risk of reductions in earnings and / or value, through financial or reputational loss, from poor corporate governance at group, divisional or business unit level. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise.

RISK APPETITE

The Group has developed an impact on earnings approach to operational risk appetite. This involves looking at how much the Group could lose due to operational risk losses at various levels of certainty.

In setting operational risk appetite, the Group looks at both impact on solvency and the Group's reputation.

For legal and regulatory risk the Group has minimal risk appetite for non-compliance with mandatory requirements and seeks to operate to high ethical standards. The Group encourages and maintains an appropriately balanced legal and regulatory compliance culture and promotes policies and procedures to enable businesses and their staff to operate in accordance with the laws, regulations and voluntary codes which impact on the Group and its activities.

EXPOSURES

The main sources of operational risk within the Group relate to the rate and scale of change arising from the Group's current integration programme, particularly in respect of people and business processes, and the legal and regulatory environment in which financial firms operate both in the UK and overseas.

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation with which the Group has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. Following the financial crisis, the pace and extent of regulatory reform proposals both in the UK and internationally have increased significantly, and can be expected to remain at high levels. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group, but could for instance affect the Group's future business strategy, structure or approach to funding. Further uncertainties arise where regulations are principles-based without the regulator defining supporting minimum standards either for the benefit of the consumer or firms. This gives rise to both the risk of retrospection from any one regulator and also to the risk of differing interpretation by individual regulators.

For legal and regulatory issues there are significant reputational impacts associated with potential censure which drive the Group's stance on appetites referred to above. There are clear accountabilities and processes in place for reviewing new and changing requirements. Each division and significant business areas have a nominated individual with 'compliance oversight' responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations, to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

Lloyds Banking Group welcomes the regulation of remuneration provided there is international consensus and we will comply with the FSA code.

MEASUREMENT

Both Lloyds TSB and HBOS had operational risk management and measurement frameworks that had been granted, by the FSA, Advanced Measurement Approach (AMA) Waivers, enabling the use of an internal model for the calculation of regulatory capital.

Throughout 2009, both frameworks have continued to operate, whilst a single integrated framework has been in the course of development. The integrated framework and capital model will be rolled out during 2010 and it is anticipated that the Group will seek a variation from the FSA to operate under a single AMA waiver.

The current measurement approaches adopted by the heritage banking groups are noted below.

Heritage Lloyds TSB Capital Model

The Lloyds TSB Group capital model calculations are driven by actual loss data (internal and external) and forward looking scenarios which value potential future risk events. External industry-wide data is collected to help with validating scenarios.

The Advanced Measurement Approach ('AMA') waiver granted by the FSA enables the outputs from the AMA capital model to be used to determine the bank's regulatory capital for Operational Risk ('OR') with effect from 1 January 2008. There is no partial use within the bank.

The Lloyds TSB operational risk capital model is an element of the operational risk framework. The aim of the model is to derive the best estimate of capital required to support potential future operational risk losses. To achieve this, the model quantifies expected and unexpected operational loss exposure using actuarial techniques. The model uses a combination of two approaches; these are the Loss Data Approach ('LDA') and the Scenario Based Approach ('SBA').

Each approach develops a set of loss distributions from which gross risk measures, such as mean and value at risk, can be derived for individual businesses and operational risk categories. These loss distributions are aggregated using Monte Carlo simulation, taking into account a weighting between the two approaches and two-step diversification effect (one between the business units and one between operational risk types). Again, gross risk measures can be taken from the aggregate distribution.

Discounts are applied to the capital requirement derived from the operational risk capital model in respect of insurance coverage and expected losses in accordance with the AMA Waiver approach agreed with the FSA.

Model Data Elements

There are four primary data collection sources for the model:

• Internal loss data;

• External loss data;

• Scenarios; and

• Internal Control Factors.

Internal Loss Data

Loss event data points are used to measure and manage operational risk, to produce internal reports for senior management and to meet external reporting requirements. Loss events and their impacts must be reported above the minimum set threshold. Capture and reporting is completed through the Lloyds TSB loss event database.

External Loss Data

External information is available through membership of the Operational Risk Data Exchange ('ORX'). ORX provides anonymous information from a number of international banks which assist in the identification, assessment and modelling of operational risk. This data is used to improve the accuracy and relevancy of external loss data used in the model. In addition, Lloyds TSB subscribes to the Algo First Database.

Scenarios

Scenarios are an important tool to analyse the exposure to large remote risks. Lloyds TSB has chosen to consider scenarios within each business unit at the first Line of Defence, as local management are closest to the business plans; risks, the relevant controls, their effectiveness and how risks might best be managed. Group wide scenarios are also used where appropriate to reflect the shared nature of some risk exposures and impacts.

Internal Control Factors

Internal Control Factors include Control Assessments and Key Indicators that influence the Scenario Analysis. Although Key Indicators are not direct inputs to the model, they are also used in the business as a management tool to support risk reporting.

Heritage HBOS Capital Model

The assessment and measurement of operational risk within HBOS is established under the Operational Risk Framework. This includes the determination of operational risk capital requirements, across the major business units, through the application of the Advanced Measurement Approach to operational risk.

Operational risk capital requirements in relation to certain joint venture operations and immaterial business units are determined under the Standardised Approach to operational risk.

The Operational Risk Model incorporates the four elements noted below and is used to model both expected and unexpected operational losses. The Model takes an actuarial approach in that it produces loss distributions based on impact and frequency parameters. The model distribution choice and calibration is validated annually.

The actual calculation and validation of operational risk capital requirements is derived through the combination of several processes. The initial process involves the Operational Risk Profile ('ORP'), the results of which are recorded on a Group wide system which produces for each category an expected loss, a Potential Severe Loss (used to provide an immediate sense check of the individual impact) and a Value at Risk estimate. The other processes involve validation of the choice and calibration of the distributions, separate modelling of the loss at risk level to compare and contrast against the profiling process and the use of scenarios to validate the total level of capital held by the Divisions and by the Group to cover operational risk. All four elements are used in parallel as part of the ORP process.

Business Environment and Control Factors

Each risk profile captures the descriptive and, where possible, quantitative information about each risk. This information is gained from a range of sources, including actual loss experience, assessments of the adequacy of key controls, reference to external losses, Key Risk Indicators ('KRIs'), internal audit reports, business plans and business and specialist expertise

KRIs are measured over time and provide useful objective information about changes in the internal risk and control environment. The analysis of KRIs and other risk information can reveal trends and exceptional values that can serve, for example, as an early warning system for management. KRIs that are more predictive about the level of risk or potential losses can be particularly useful.

The Control Assurance ('CA') process assists business managers in providing assurance on the effectiveness of the internal control environment. It is a critical input and provides essential management information to the Executive and business managers on areas of potential exposure.

CA is an indirect input to the Operational Risk Model and informs risk owners of their business risk and control environment. The effectiveness, or not, of a control may influence the assessment of an operational risk and potential capital holding.

Internal Loss Data

Internal loss data involves event reporting, being the capture of risk events, actual losses and near misses. It is used to provide input to and challenge for the ORP process and is modelled to back test the VaR figures used to generate the capital requirement.

Divisions are required to follow minimum standards in reporting operational risk events to the appropriate Committee or function. These standards define the threshold for reporting through consideration of the Maximum Potential Exposure. In addition, the standards define the criteria for the identification and capture of operational risk events with a Maximum Potential Exposure below the threshold, for high volume low value losses known as Frequent Loss Data.

External Loss Data

External data can provide an important additional source of information to assist businesses in setting and others to challenge operational risk profiles more objectively.

External information is available through membership of the Operational Risk Data Exchange (ORX).

Scenarios

HBOS uses scenario analysis in conjunction with external data to evaluate its exposure to high severity events.

Operational risk scenario analysis is the assessment of the impact of unlikely or extreme yet plausible operational risk events. The purpose of the scenario analysis is to allow the business to assess its internal control environment in such an extreme situation and test the overall level of capital for that extreme event. Divisions agree the scenarios relevant to their business with group operational risk.

MITIGATION

Both Lloyds TSB and HBOS's operational risk management frameworks consist of the following key components:

– Identification and categorisation of the key operational risks facing a business area.

– Risk assessment, including impact assessment of financial and non-financial impacts (e.g. reputational risk) for each of the key risks to which the business area is exposed.

– Control assessment, evaluating the effectiveness of the control framework covering each of the key risks to which the business area is exposed.

– Loss and incident management, capturing actions to manage any losses facing a business area.

– The development of Key Risk Indicators for management reporting.

– Oversight and assurance of the risk management framework in divisions and businesses.

– Scenarios for estimation of potential loss exposures for material risks.

Use of Insurance

The heritage Lloyds TSB methodology calculates the corporate insurance offset based on Lloyds TSB's operational risk framework and utilises operational risk event type categories and scenarios developed by business units. This methodology

- maps identified loss scenarios to the current insurances
- considers the "operational risk of insurance failing" to calculate appropriate haircuts
- calculates a resultant capital figure which is potentially mitigated by insurance (based on the Group Operational Risk calculations of operational risk capital).

Heritage HBOS methodology does not utilise insurance for the purpose of mitigating operational risk.

MONITORING

Business unit risk exposure are aggregated at divisional level and reported to group risk where a group-wide report is prepared. The report is discussed at the monthly group compliance and operational risk committee. This committee can escalate matters to the chief risk officer, or higher committees if appropriate.

The insurance programme is monitored and reviewed regularly, with recommendations being made to the Group's senior management annually prior to each renewal. Insurers are monitored on an ongoing basis, to ensure counterparty risk is minimised. A process is in place to manage any insurer rating changes or insolvencies.

The Group has adopted a formal approach to operational risk event escalation. This involves the identification of an event, an assessment of the materiality of the event in accordance with a risk event impact matrix and appropriate escalation.

OPERATIONAL RISK CAPITAL REQUIREMENT

As at 31 December 2009, the capital requirement in respect of operational risk amounted to £2,027m of which £1,982m has been derived under the Advanced Measurement Approach and £45m under the Standardised Approach.

APPENDIX 1

LLOYDS TSB BANK PLC (GROUP)

CAPITAL RESOURCES AND CAPITAL REQUIREMENTS

LLOYDS TSB BANK PLC (GROUP) CAPITAL RESOURCES

The capital resources of Lloyds TSB Bank plc (Group) as at 31 December 2009 are presented in the table below.

	31 December 2009 £m	31 December 2009 £m	31 December 2008 £m	31 December 2008 £m
Core tier 1				
Ordinary share capital and reserves		13,753		9,446
Regulatory post-retirement benefit adjustments		249		435
Available-for-sale revaluation reserve and cash flow hedging reserve		1,602		2,997
Other items		(1)		3
		15,603		**12,881**
Deductions from core tier 1				
Goodwill and other intangible assets		(2,127)		(2,356)
Excess expected loss		(838)		(920)
Other deductions		(215)		(179)
Core tier 1 capital		**12,423**		**9,426**
Perpetual non-cumulative preference shares				
Preference share capital		3,030		1,974
Innovative tier 1 capital instruments				
Preferred securities (net of restriction in amount eligible)		2,854		2,174
Total Tier 1 capital		**18,307**		**13,574**
Total Tier 1 capital after deductions and restrictions (excluding Innovative tier 1)	*15,453*		*11,400*	
Upper tier 2				
Available-for-sale revaluation reserve in respect of equities		6		8
Undated subordinated debt		1,914		5,192
Innovative capital restricted from tier 1		2,074		995
Eligible provisions		25		21
Lower tier 2				
Dated subordinated debt		4,711		5,320
Deductions from tier 2				
Excess expected loss		(838)		(920)
Other deductions		(215)		(179)
Total Tier 2 capital		**7,677**		**10,437**
Total Tier 2 capital after deductions and restrictions (including innovative tier 1)	*10,531*		*12,611*	
Supervisory Deductions				
Unconsolidated investments – life		(4,586)		(4,208)
Unconsolidated investments – other		(596)		(550)
Total supervisory deductions		**(5,182)**		**(4,758)**
Total Capital Resources		**20,802**		**19,253**
Risk Weighted Assets		**174,472**		**170,490**
Core tier 1 ratio (%)		**7.1%**		**5.5%**
Tier 1 capital ratio (%)		**10.5%**		**8.0%**
Total capital ratio (%)		**11.9%**		**11.3%**

LLOYDS TSB BANK PLC (GROUP) RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of Lloyds TSB Bank plc (Group) as at 31 December 2009 are presented in the table below.

(All figures are in £m)	Risk Weighted Assets	Pillar 1 Capital Requirements
CREDIT RISK		
Exposures subject to the IRB Approach		
Foundation IRB Approach		
Corporate - Main	47,437	3,795
Corporate - SME	6,114	489
Corporate - Specialised lending	11,014	881
Central governments and central banks	877	70
Institutions	2,179	174
Retail IRB Approach		
Retail - Residential mortgages	27,860	2,229
Retail - Originated, securitised residential mortgages	8,281	663
Retail - Qualifying revolving retail exposures	10,103	808
Retail - Other retail	13,775	1,102
Retail - SME	2,396	192
Other IRB Approaches		
Corporate - Specialised lending	3,143	252
Securitisation positions	5,965	477
Non Credit Obligation Assets	1,454	116
Total - IRB Approach	**140,598**	**11,248**
Exposures subject to the Standardised Approach		
Central governments and central banks	83	7
Regional governments or local authorities	-	-
Administrative bodies and non-commercial undertakings	16	1
Institutions	204	16
Corporates	4,705	376
Retail	1,558	125
Secured on real estate property	1,365	109
Past due items	135	11
Items belonging to regulatory high risk categories	4,067	325
Collective investment undertakings	8	1
Other items	5,585	447
Total - Standardised Approach	**17,726**	**1,418**
Total Credit Risk	**158,324**	**12,666**
COUNTERPARTY CREDIT RISK		
IRB Approach	4,478	358
Total Counterparty Credit Risk	**4,478**	**358**
MARKET RISK		
Internal Models Approach		
Interest Rate PRR	1,604	128
Standardised Approach		
Interest Rate PRR	4	-
Foreign Currency PRR	105	9
Commodity PRR	9	1
Total Market Risk	**1,722**	**138**
OPERATIONAL RISK		
Advanced Measurement Approach	9,948	796
Total Operational Risk	**9,948**	**796**
TOTAL	**174,472**	**13,958**

APPENDIX 2

BANK OF SCOTLAND PLC (GROUP)

CAPITAL RESOURCES AND CAPITAL REQUIREMENTS

BANK OF SCOTLAND PLC (GROUP) CAPITAL RESOURCES

The capital resources of Bank of Scotland plc (Group) as at 31 December 2009 are presented in the table below.

	31 December 2009		31 December 2008	
	£m	£m	£m	£m
Core tier 1				
Ordinary share capital and reserves		22,147		11,661
Available-for-sale revaluation reserve		2,972		5,335
Cash flow hedging reserve		839		1,041
Other items		150		(376)
		26,108		17,661
Deductions from core tier 1				
Goodwill and other intangible assets		(565)		(1,211)
Excess expected loss		(920)		(536)
Other deductions		(556)		(484)
Core tier 1 capital		24,067		15,430
Perpetual non-cumulative preference shares				
Preference share capital		800		1,200
Innovative tier 1 capital instruments				
Innovative tier 1 capital		698		698
Total Tier 1 capital		**25,565**		**17,328**
Total Tier 1 capital after deductions and restrictions (excluding Innovative tier 1)	*24,867*		*16,630*	
Upper tier 2				
Available-for-sale revaluation reserve in respect of equities		22		-
Undated subordinated debt		5,206		5,551
Eligible provisions		1,669		1,454
Lower tier 2				
Dated subordinated debt		8,691		9,094
Deductions from tier 2				
Excess expected loss		(920)		(536)
Other deductions		(556)		(325)
Total Tier 2 capital		**14,112**		**15,238**
Total Tier 2 capital after deductions and restrictions (including innovative tier 1)	*14,810*		*15,936*	
Supervisory Deductions				
Unconsolidated investments		(1,062)		(919)
Total Capital Resources		**38,615**		**31,647**
Risk Weighted Assets		**322,866**		**326,703**
Core tier 1 ratio (%)		**7.5%**		**4.7%**
Tier 1 capital ratio (%)		**7.9%**		**5.3%**
Total capital ratio (%)		**12.0%**		**9.7%**

BANK OF SCOTLAND PLC (GROUP) RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of Bank of Scotland plc (Group) as at 31 December 2009 are presented in the table below.

(All figures are in £m)	Risk Weighted Assets	Pillar 1 Capital Requirements
CREDIT RISK		
Exposures subject to the IRB Approach		
Advanced IRB Approach		
Corporate - Main	65,914	5,273
Corporate - SME	19,021	1,522
Central governments and central banks	132	11
Institutions	7,009	561
Retail IRB Approach		
Retail - Residential mortgages	38,771	3,102
Retail - Originated, securitised residential mortgages	2,450	196
Retail - Qualifying revolving retail exposures	13,751	1,100
Retail - Other retail	6,990	559
Retail - SME	126	10
Other IRB Approaches		
Corporate - Specialised lending	4,689	375
Equities - Exchange traded	432	35
Equities - Private equity	2,534	202
Equities - Other	2,338	187
Securitisation positions	7,673	614
Total - IRB Approach	**171,830**	**13,747**
Exposures subject to the Standardised Approach		
Central governments and central banks	-	-
Regional governments or local authorities	25	2
Administrative bodies and non-commercial undertakings	307	25
Institutions	38	3
Corporates	48,029	3,842
Retail	6,527	522
Secured on real estate property	38,006	3,040
Past due items	14,051	1,124
Items belonging to regulatory high risk categories	2	-
Securitisation positions	558	45
Short term claims on institutions or corporates	632	51
Other items	18,443	1,475
Total - Standardised Approach	**126,618**	**10,129**
Total Credit Risk	**298,448**	**23,876**
COUNTERPARTY CREDIT RISK		
IRB Approach	1,214	97
Standardised Approach	6,553	524
Total Counterparty Credit Risk	**7,767**	**621**
MARKET RISK		
Internal Models Approach	500	40
Standardised Approach		
Interest Rate PRR	1,374	110
Foreign Currency PRR	23	2
Total Market Risk	**1,897**	**152**
OPERATIONAL RISK		
Advanced Measurement Approach	14,374	1,150
Standardised Approach	380	30
Total Operational Risk	**14,754**	**1,180**
TOTAL	**322,866**	**25,829**

APPENDIX 3

GLOSSARY

GLOSSARY

Advanced Internal Ratings Based (AIRB) Approach
Application of the Advanced Internal Ratings Based (AIRB) Approach allows internal estimates of PD, LGD and EAD to be used by the Group in determining credit risk capital requirements for retail and wholesale portfolios. Application of this approach to retail portfolios is commonly referred to as the Retail IRB Approach.

Advanced Measurement Approach (AMA)
The most sophisticated method for determining operational risk capital requirements is referred to as the Advanced Measurement Approach (AMA). It requires the use of internal operational risk measurement systems.

Arrears
A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue.

Asset Backed Securities (ABS)
Asset Backed Securities are securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles and student loans.

Asset Backed Commercial Paper (ABCP)
See **Commercial Paper**

Collateralised Debt Obligations (CDOs)
Collateralised Debt Obligations are securities issued by a third party which reference Asset Backed Securities (ABS) and / or certain other related assets purchased by the issuer. Lloyds Banking Group has not established any programmes creating CDOs but has invested in instruments issued by other banking groups. These are primarily CLOs, CBOs, CREs and CDOs.

Commercial Mortgage Backed Securities (CMBS)
Commercial Mortgage Backed Securities are securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).

Commercial Paper (CP)
Commercial paper is an unsecured promissory note issued to finance short-term credit needs. It specifies the face amount paid to investors on the maturity date. Commercial Paper can be issued as an unsecured obligation of the Group, or for example when issued by the Group's conduits as an asset backed obligation (in such case it is referred to as asset backed commercial paper). Commercial Paper is usually issued for periods from as little as a week up to nine months.

Commercial real estate
Commercial real estate includes office buildings, industrial property, medical centres, hotels, malls, retail stores, shopping centres, farm land, multifamily housing buildings, warehouses, garages, and industrial properties.

Conduits
A financial vehicle that holds asset backed securities which are financed with short-term loans (generally commercial paper) that use the asset backed securities as collateral. The conduit will often have a liquidity line provided by a bank that it can draw down on in the event that it is unable to issue funding to the market. The Group sponsors three asset backed conduits, Cancara, Grampian and Landale.

Contractual maturities
Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.

Credit Conversion Factor (CCF)
Credit conversion factors (CCF) are used in determining the exposure at default (EAD) in relation to a credit risk exposure. The CCF is an estimate of the proportion of undrawn commitments expected to be drawn down at the point of default.

Credit Default Swaps (CDS)
A credit default swap is also referred to as a credit derivative. It is an arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency.

Credit risk spread (or credit spread)
The credit spread is the yield spread between securities with the same currency and maturity structure but with different associated credit risks, with the yield spread rising as the credit rating worsens. It is the premium over the benchmark or risk-free rate required by the market to take on a lower credit quality.

Expected Loss (EL)
Expected loss (EL) represents the anticipated loss, in the event of default, on a credit risk exposure modelled under the internal ratings based approach. EL is determined by multiplying the associated PD%, LGD% and EAD together and assumes a 12 month time horizon.

Exposure at Default (EAD)
Exposure at default (EAD) represents the estimated exposure to a customer in the event of default. In determining EAD amounts, consideration is made of the extent to which undrawn commitments may be drawn down at the point of default (see **Credit Conversion Factors**) and the application of credit risk mitigation. Analysis of credit risk exposures under Pillar 3 is typically based on EAD amounts, prior to the application of credit risk mitigation.

External Credit Assessment Institutions (ECAI)
External Credit Assessment Institutions (ECAIs) include external credit rating agencies such as Standard & Poor's, Moody's and Fitch.

Foundation Internal Ratings Based (FIRB) Approach
As with the Advanced Internal Ratings Based (AIRB) Approach, application of the Foundation Internal Ratings Based (FIRB) Approach allows internal estimates of PD to be used by the Group in determining credit risk capital requirements for wholesale portfolios. However, LGD and EAD are determined in accordance with standard parameters set by the regulator rather than on the basis of internal estimates. The FIRB Approach cannot be applied to retail portfolios.

Guaranteed mortgages
Mortgages for which there is a guarantor to provide the lender a certain level of financial security in the event of default of the borrower.

Impaired loans	Impaired loans are loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.
Impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Individually / Collectively assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Loans past due	Loans are past due when a counterparty has failed to make a payment when contractually due.
Loss Given Default (LGD)	Loss given default (LGD) represents the estimated proportion of an EAD amount that will be lost in the event of default.
Mortgage related assets	Assets which are referenced to underlying mortgages.
Private equity investments	Private equity is equity securities in operating companies not quoted on a public exchange. Investment in private equity often involves the investment of capital in private companies or the acquisition of a public company that results in the delisting of public equity. Capital for private equity investment is raised by retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.
Point-in-time (PIT)	Estimates of PD (or other measures) made on a point-in-time (PIT) basis generally cover a short time horizon (usually a 12 month period) and are sensitive to changes in the economic cycle. This differs from a through-the-cycle (TTC) basis which uses long run average economic and risk data to reduce such sensitivity.
Probability of Default (PD)	Probability of default (PD) represents an estimate of the likelihood that a customer will default within a 12 month time horizon.
Qualifying Revolving Retail Exposure (QRRE)	Qualifying Revolving Retail Exposures (QRRE) relate to revolving, unsecured retail exposures that, to the extent they are not drawn, are immediately and unconditionally cancellable. Such exposures include credit cards and overdraft facilities.
Repurchase agreements or 'repos'	Short-term funding agreements which allow a borrower to sell a financial asset, such as ABS or Government bonds as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.
Retail Internal Ratings Based (Retail IRB) Approach	The application of the Advanced Internal Ratings Based (AIRB) Approach to retail portfolios is commonly referred to as the Retail Internal Ratings Based (Retail IRB) Approach.
Retail loans	Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as mortgages and credit card balances.
Residential Mortgaged Backed Securities (RMBS)	Residential Mortgage Backed Securities are a category of ABS. They are securities that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. Securitisation is the process by which ABS are created. A company sells assets to a special purpose entity which then issues securities backed by the assets. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. Assets used in securitisations include mortgages to create mortgage backed securities or residential mortgage-backed securities (RMBS) as well as commercial mortgage backed securities (CMBS). The Group has established several securitisation structures as part of its funding and capital management activities. These generally use mortgages, corporate loans and credit cards as asset pools.
Special Purpose Entities (SPEs)	SPEs are entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set-up under securitisation programmes, and as conduits. Where the Group has control of these entities or retains the risks and rewards relating to them they are consolidated within the Group's results.
Standardised Approach	The Standardised Approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by ECAIs to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements.
Student loan related assets	Assets which are referenced to underlying student loans.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Through-the-cycle (TTC)	See **Point-in-time (PIT)**
Value at Risk (VaR)	Value at Risk is an estimate of the potential loss in earnings which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a confidence level of 95 per cent.
Write downs	The depreciation or lowering of the value of an asset in the books to reflect a decline in their value, or expected cash flows.

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