Lloyds Banking Group plc

Pillar 3 Disclosures
31 December 2013

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FORWARD LOOKING STATEMENTS

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

Examples of such forward looking statements include, but are not limited to: projections or expectations of the 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 the Group or its management including in respect of certain synergy targets; statements about the future business and economic environments in the United Kingdom (UK) and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, without limitation, as a result of the Group's Simplification Programme; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; 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, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union (EU), the US or elsewhere; the implementation of the draft EU crisis management framework directive and banking reform, following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Group as a result of HM Treasury's investment in the Group; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EU State Aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; market related trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and the success of the Group in managing the risks of the foregoing. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors, together with examples of forward looking statements.

Lloyds Banking Group may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds Banking Group annual reviews, half-year announcements, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward looking statements contained in this 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 ('the Group') as at 31 December 2013.

The disclosures produced have been prepared in accordance with minimum disclosure requirements established under the Capital Requirements Directive ('CRD'), as modified for both the 'CRD II' and 'CRD III' packages of amendments, and commonly referred to as Basel 2.5.

On 1 January 2014 the new Capital Requirements Directive and Regulation ('CRD IV') came into force. Additional disclosure requirements under the new legislation, a summary of which are provided on page 11, will apply to the Group's 2014 Pillar 3 disclosures.

Directive imposed disclosure requirements as at 31 December 2013 are implemented within the UK through the version of the Prudential Regulation Authority's ('PRA') Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU') applicable at that date.

In meeting these disclosure requirements the Group has considered work undertaken by the European Banking Authority ('EBA') and both national and international trade associations in interpreting Pillar 3 disclosure requirements and in establishing best practice guidelines. During the course of 2013 the Group continued to be actively involved in industry discussions with the PRA in response to the UK Financial Policy Committee's recommendation that UK banks should work with the PRA and the British Bankers' Association ('BBA') to achieve, over time, greater consistency and comparability between their Pillar 3 disclosures. Building upon the initial disclosure enhancements included in the 2012 disclosures, additional enhancements, primarily relating to the adoption of Enhanced Disclosure Task Force ('EDTF') recommendations, have been included in the 2013 disclosures and consist of the following:

- A reconciliation of regulatory balance sheet assets to gross drawn credit risk exposures (page 17)
- An analysis of risk weighted asset movement by key driver (page 30)
- Key characteristics of material Group ratings systems (page 56)
- An expanded Corporate Master Scale for Foundation IRB exposures (pages 57 to 60 and 103 to 104)
- An analysis of Retail IRB Residential Mortgages by major portfolio (page 62)
- Enhanced market risk disclosures (pages 106 to 115)

A list summarising all 32 EDTF recommendations, and the location of the disclosures prepared by the Group in meeting these, can be found on page 391 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

In addition to the above, the PRA have requested that the Group, along with other major UK banks, disclose the following via their 2013 year end disclosures:

- A group level reconciliation, on a consistent basis, between accounting capital as published in the financial statements and the CRD IV transitional capital position. In meeting this requirement, the Group is required to take account of the approach to CRD IV transition as set out in the PRA Rulebook that came into force on 1 January 2014. The Group has, in addition, provided a disclosure of its capital position on a fully loaded CRD IV basis.

- A leverage ratio calculated on a fully loaded CRD IV basis, with the exposure measure adjusted to reflect the requirements of the original December 2010 Basel III leverage ratio framework, as interpreted through guidance released in July 2012 ('Basel III December 2010 rules'). In addition to the calculation basis specified by the PRA, the Group's leverage ratio is disclosed on a final CRD IV rules basis ('CRD IV rules') and estimated in accordance with the revised Basel III leverage ratio framework issued on 12 January 2014 ('Basel III January 2014 rules'). In each case the ratio is presented on a transitional basis, a fully loaded basis and a fully loaded basis inclusive of tier 1 instruments.

The relevant disclosures can be found on pages 25 to 28, with further detailed analysis of the Group's CRD IV transitional and fully loaded capital positions presented in Appendix 1 of the document.

In satisfaction of significant subsidiary disclosure requirements, summary information pertaining to the consolidated capital resources and consolidated capital requirements of Lloyds Bank plc ('Lloyds Bank Group') and Bank of Scotland plc ('BOS Group') as at 31 December 2013 can be found in Appendix 2 and Appendix 3 of the document.

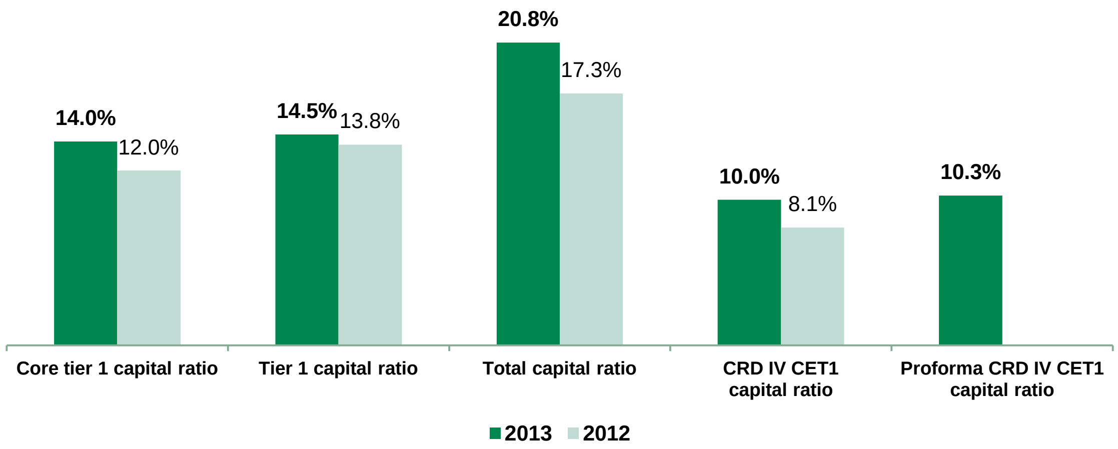
Remuneration disclosures produced in compliance with CRD III requirements on the disclosure of remuneration can be found in Appendix 4 of the document.

SUMMARY ANALYSIS

A high level summary analysis of the consolidated capital position, requirements and credit risk exposures of the Group as at 31 December 2013 is provided below.

CAPITAL AND LEVERAGE RATIOS

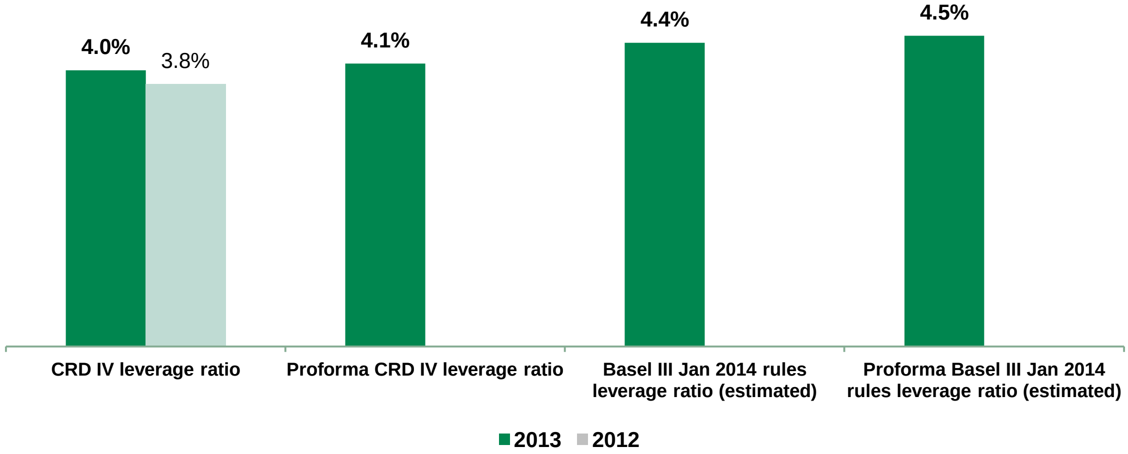
Table 1: **Capital ratios**



Notes

- The 2013 core tier 1, tier 1 and total capital ratios are calculated in accordance with the rules prevailing at 31 December 2013.
- The 2013 CRD IV common equity tier 1 capital ratio is calculated on a fully loaded basis in accordance with final CRD IV rules and the PRA Rulebook. The proforma version reflects the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.
- Prior year comparatives are as disclosed at 31 December 2012.

Table 2: **Leverage ratios**



Notes

- The 2013 CRD IV leverage ratio is calculated on a fully loaded basis (inclusive of tier 1 instruments, as defined on page 27), in accordance with final CRD IV rules. Excluding tier 1 instruments, the CRD IV leverage ratio is 3.4% (proforma 3.4%). The prior year comparative is as disclosed at 31 December 2012.
- The Basel III (January 2014 rules) leverage ratio has been estimated on the basis of the revised Basel III leverage ratio framework published on 12 January 2014 (inclusive of tier 1 instruments, as defined on page 27). Excluding tier 1 instruments, the Basel III (January 2014 rules) leverage ratio is 3.7% (proforma 3.8%).
- The 2013 leverage ratio under the basis prescribed by the PRA (Basel III December 2010 rules) was 3.9% (inclusive of tier 1 instruments, as defined on page 27) and 4.0% on a proforma basis. Excluding tier 1 instruments the PRA (Basel III December 2010 rules) ratio is 3.3% (proforma 3.4%).
- Proforma versions of the ratio reflect the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.
- Further analysis of the Group's leverage ratio is presented on page 28.

RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

Total risk weighted assets ('RWAs') as at 31 December 2013 amounted to £263.9bn (2012: £310.3bn), generating a Pillar 1 capital requirement of £21.1bn (2012: £24.8bn). A summary breakdown of total RWAs by risk type and by division is provided in the tables below.

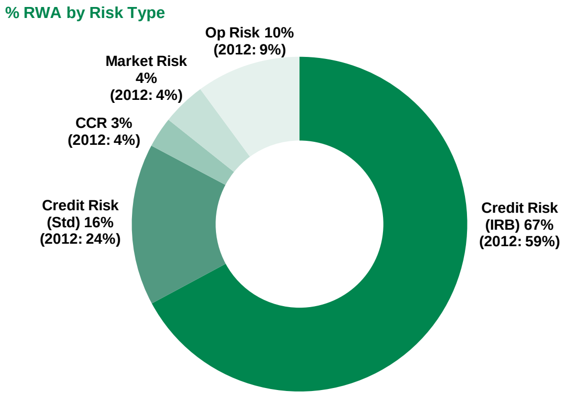
Table 3: **Summary of risk weighted assets**

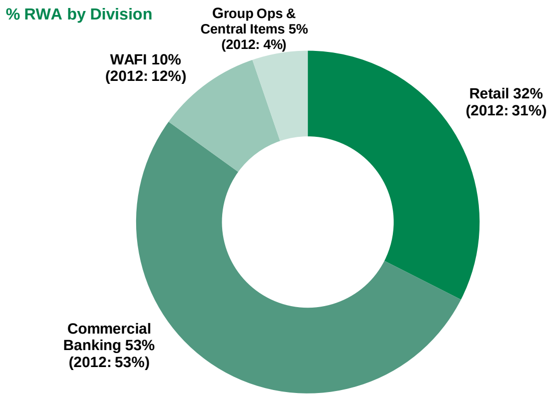
Risk Type	2013 Risk Weighted Assets £m	2012 Risk Weighted Assets £m
Credit risk (Internal Ratings Based 'IRB' Approach)	**177,230**	184,453
Credit risk (Standardised Approach)	**41,150**	73,665
	218,380	258,118
Counterparty credit risk	**7,794**	12,848
Market risk	**11,082**	11,394
Operational risk	**26,594**	27,939
Total Risk Weighted Assets	**263,850**	310,299

Table 4: **Summary divisional analysis of risk weighted assets**

Division	2013 Risk Weighted Assets £m	2012 Risk Weighted Assets £m
Retail	**85,677**	95,470
Commercial Banking	**138,541**	165,209
Wealth, Asset Finance and International ('WAFI')	**25,886**	36,167
Group Operations and Central Items	**13,746**	13,453
Total Risk Weighted Assets	**263,850**	310,299

Table 5: **Split of risk weighted assets**





Key Movements

- Retail RWAs reduced by £9.8bn in the year primarily due to improvements in credit quality reflecting effective portfolio management and the impact of positive macroeconomic factors, including favourable movements in UK house prices.
- The reductions in RWAs of £26.7bn in Commercial Banking and £10.3bn in Wealth, Asset Finance and International primarily reflect further non-core asset reduction, the move to IRB Supervisory Slotting Approach models for Commercial Real Estate businesses and the impact of macroeconomic factors.
- The reduction in Standardised Approach RWAs is largely due to the roll-out of new IRB models during the year, predominantly the implementation of IRB Supervisory Slotting Approach models in the UK and Ireland, and non-core disposals.
- Counterparty credit risk RWAs reduced from £12.8bn to £7.8bn. Contributing to this reduction are mark-to-market changes, management actions and the migration of portfolios from the Standardised Approach to the IRB Approach.
- Market risk RWAs continue to reflect the impact of a temporary capital buffer applied to the Group's internal market risk models. This buffer is expected to be removed once specific market risk infrastructure projects have been completed.
- Operational risk RWAs are determined under the Standardised Approach, a description of which is provided on page 10. The reduction in RWAs of £1.3bn is a result of a reduction in the three year rolling average income used in the calculation.

CREDIT RISK EXPOSURES

Total credit risk exposures (excluding counterparty credit risk exposures) as at 31 December 2013 amounted to £724.9bn (2012: £759.0bn) on an exposure at default ('EAD') basis, as defined on page 12. This comprises £592.4bn (82%) of exposures risk weighted under the IRB Approach (2012: £575.9bn, 76%) and £132.5bn (18%) of exposures risk weighted under the Standardised Approach (2012: £183.1bn, 24%). A summary analysis of credit risk exposures is provided in the table below.

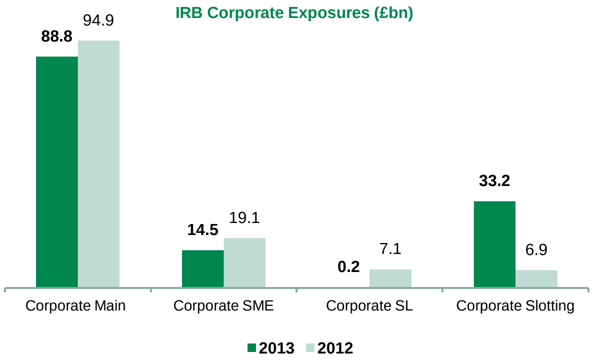
Table 6: **Summary of credit risk exposures**

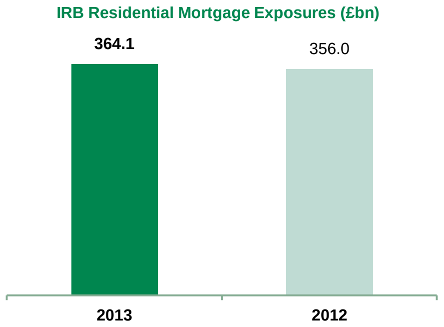
Exposure Category	2013 Credit Risk Exposure £m	2013 Risk Weighted Assets £m	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Risk Weighted Assets £m	2012 Average Risk Weight %
Corporates	136,597	79,952	59%	127,927	77,728	61%
Central governments and central banks	15,063	1,579	10%	10,238	1,437	14%
Institutions	5,318	1,339	25%	5,690	1,447	25%
Retail	418,696	85,139	20%	409,387	91,445	22%
Equities	2,934	5,902	201%	2,824	5,709	202%
Securitisation positions	13,860	3,319	24%	19,847	6,687	34%
Total – IRB Approach	592,468	177,230	30%	575,913	184,453	32%
Central governments and central banks	78,523	49	0%	93,094	105	0%
Institutions	948	295	31%	1,201	566	47%
Corporates	18,354	16,974	92%	27,290	25,537	94%
Retail	5,325	4,023	76%	7,479	5,604	75%
Secured by mortgages on residential property	7,098	2,535	36%	15,891	6,950	44%
Secured by mortgages on commercial real estate	191	206	108%	13,821	15,200	110%
Other [1]	22,034	17,068	77%	24,343	19,703	81%
Total – Standardised Approach	132,473	41,150	31%	183,119	73,665	40%
TOTAL	724,941	218,380	30%	759,032	258,118	34%

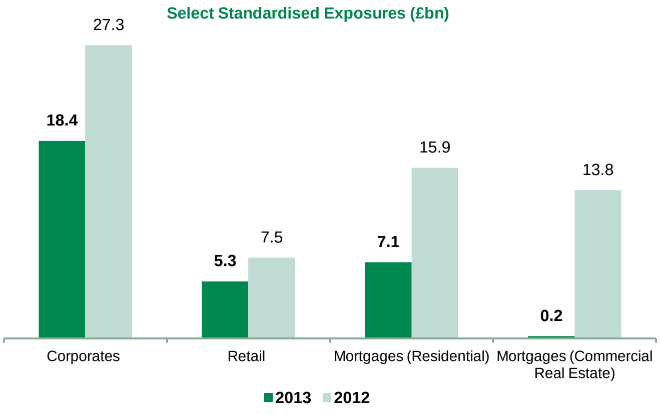
Notes

[1] Other exposures include exposures to regional governments and local authorities, administrative bodies and non-commercial undertakings, multilateral development banks, past due items, items belonging to regulatory high risk categories, short term claims on institutions or corporates, collective investment undertakings and other items.

Table 7: **Credit risk exposure analysis**







Key Movements

- IRB Corporate Main exposures reduced during the year primarily reflecting non-core disposals and asset run off, partially offset by increased core lending.
- IRB Corporate SME exposures reduced during the year, primarily as a result of transfers to other exposure classes.
- The significant reduction in IRB Corporate SL, Standardised Corporates and Standardised Commercial Real Estate Mortgages reflected both the transitioning of Commercial Real Estate portfolios to the IRB Supervisory Slotting Approach (IRB Corporate Slotting) and non-core disposals.
- The reduction in Standardised Residential Mortgages and Standardised Retail exposures reflected the roll-out of Dutch Residential Mortgage portfolios on to the Retail IRB Approach (the main driver of the increase in IRB Residential Mortgage exposures) and the disposal of the Group's Spanish and Australian businesses.

A detailed analysis of the key movements in exposures and risk weighted assets is provided on pages 37 and 38.

INTRODUCTION AND BACKGROUND

Prudential requirements under the Basel framework are categorised under three pillars as described below.

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, counterparty credit, market and operational risks. Capital requirements are more commonly expressed as risk weighted assets, being 12.5 times the capital required. A range of approaches, varying in sophistication, are available under the Basel II framework to use in measuring these risks and to determine the minimum level of capital required. A summary of these approaches and their application by the Group is noted below.

Credit Risk and Counterparty Credit Risk

Standardised Approach

Description

- Low risk sensitivity and complexity.
- Relies on the application of a standardised set of risk weightings to credit risk exposures.
- External credit ratings supplied by External Credit Assessment Institutions ('ECAIs', for example Standard & Poor's, Moody's or Fitch) may be used in determining the appropriate risk weight to apply.
- Recognises the application of certain credit risk mitigation techniques.
- No distinction made between expected and unexpected losses.

Group Application

The Group applies the Standardised Approach to portfolios awaiting roll-out under the Group's IRB roll-out plan and to portfolios that have been permanently exempted from the IRB Approach under the terms of the Group's IRB Waiver Permission.

Internal Ratings Based (IRB) Approach

Description

- High risk sensitivity and complexity.
- A variety of IRB approaches exist depending on the type of exposure and waiver permission in place.
- There are two main approaches for wholesale exposures – the **Foundation IRB Approach ('FIRB')** and the **Advanced IRB Approach ('AIRB')**. For retail exposures, a single approach referred to as the **Retail IRB Approach ('RIRB')** is available and is equivalent in complexity to the Advanced IRB Approach.
- The FIRB, AIRB and RIRB approaches require firms to make use of their own internal assessment, subject to regulatory floors, of the probability of a counterparty defaulting ('PD'). In addition, firms applying the AIRB and / or RIRB approach are required to use internal credit conversion factors in deriving exposure at default ('EAD') amounts and internal estimates of loss given default ('LGD') in a downturn. Firms applying the FIRB approach are also required to use credit conversion factors and LGD components within their calculations, but these are set by the regulator.
- The PD, LGD and EAD of a credit risk exposure form the base inputs to the calculation used to derive the RWA in respect of that exposure, from which the credit risk capital requirement is derived (being 8 per cent of the RWA), reflecting the capital required to cover any unexpected loss in relation to the exposure.
- An expected loss ('EL') is derived by multiplying the PD, LGD and EAD risk components together, aligning to long run average PDs and downturn LGDs where available. As such the EL calculated represents an estimate of the monetary amount the business expects to lose from an obligor within a 12 month outcome window, irrespective of current economic conditions. Where expected losses exceed accounting impairment provisions linked to the underlying credit risk exposures the resultant 'excess EL' is deducted from capital resources, split equally between core 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.
- Alternative methodologies exist under the IRB approach for use in risk weighting specific exposure types. These include the **Supervisory Slotting Approach** for corporate specialised lending exposures, the **Simple Risk Weight Method** for equity exposures and the **Ratings Based Approach ('RBA')** and **Internal Assessment Approach ('IAA')** for securitisation positions.
- Firms must use their IRB model outputs to inform both credit risk management and day to day credit related decision making within the business (the 'Use Test'). Application of an IRB approach requires PRA approval in the form of a waiver permission.

Group Application

Both the Foundation IRB Approach and the Retail IRB Approach are used within the Group. The Group does not currently have permission to utilise the Advanced IRB Approach for wholesale portfolios. The Group applies the Supervisory Slotting Approach to certain corporate specialised lending exposures and the Simple Risk Weight Method to equity exposures. Securitisation positions are predominantly risk weighted under the Ratings Based Approach, with limited use made of the Internal Assessment Approach.

Counterparty credit risk exposures are first measured under the Mark-to-Market Method, prior to being risk weighted under either the Standardised Approach or relevant IRB approach, as appropriate.

Market Risk

Standardised Approach	**Description** - Low risk sensitivity and complexity. - Requires the calculation of position risk requirements (‘PRR’) for each type of market risk in the trading book in accordance with standard rules set by the PRA. **Group Application** The Group calculates position risk requirements for trading book positions that are not covered by the scope of the Group’s internal VaR models. These include the Group’s trading books in Australia, inflation referenced positions, certain FX and credit trading positions and equity positions.
Internal Models Approach	**Description** - High risk sensitivity and complexity. - Involves the use of internal Value at Risk ('VaR') models to measure market risks in the trading book and determine appropriate capital requirements. - PRA approval is required before VaR models can be used for capital calculation purposes. **Group Application** The Group is permitted by the PRA to calculate market risk capital requirements for its trading book positions using its VaR models. The Group applies the Internal Models Approach to the majority of its trading book positions.

Operational Risk

Basic Indicator Approach (BIA)	**Description** - Low risk sensitivity and complexity. - The capital requirement equates to 15 per cent of the 'relevant indicator' as defined under BIPRU. This indicator is based on the three year average of the sum of the firm's net interest income and net non-interest income, subject to allowable adjustments. **Group Application** The Group does not apply the Basic Indicator Approach.
Standardised Approach (TSA)	**Description** - Medium risk sensitivity and complexity. - The capital requirement is derived from the three year average of the aggregate risk weighted relevant indicators of the underlying business. This requires a firm's activities to be split into a number of defined business lines with a specific risk weight applied to the relevant indicator of each business line. An Alternative Standardised Approach is also available which uses alternative indicators in relation to the defined business lines. - Firms must meet certain qualifying criteria to be able to use the Standardised or Alternative Standardised Approach. **Group Application** The Group calculates its operational risk capital requirements under the Standardised Approach. No use is made of the Alternative approach.
Advanced Measurement Approach (AMA)	**Description** - High risk sensitivity and complexity. - The capital requirement is determined through the use of internal operational risk measurement systems. Use of this approach requires approval from the PRA and can only be used where internal systems for monitoring and measuring operational risk are sufficiently robust. **Group Application** The Group does not apply the Advanced Measurement Approach.

Further details on the Group’s application of the IRB Approach (credit and counterparty credit risks) and the Internal Models Approach (market risk) are provided on pages 52 to 56 and 106 to 112, respectively.

PILLAR 2 – SUPERVISORY REVIEW PROCESS

The second pillar of the Basel 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 upon the capital position that is forecast to occur using stressed macroeconomic 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 PRA 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 PRA 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') and a minimum capital buffer through the setting of a Capital Planning Buffer.

A summary of the Group's approach to the ICAAP and the material risks identified in addition to those captured under Pillar 1 are presented on page 33.

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 II framework sets out the minimum disclosures required under Pillar 3. Together with additional minimum disclosure requirements imposed through amendments to the original Capital Requirements Directive, these form the basis of the disclosures the Group is required to make under the relevant BIPRU provisions.

FUTURE REGULATORY DEVELOPMENTS

The new Capital Requirements Directive and Regulation (CRD IV), designed to implement the Basel III reforms of the Basel Committee on Banking Supervision, came into force within the European Union on 1 January 2014.

From a Pillar 3 perspective, CRD IV introduces new disclosure requirements surrounding risk management, corporate governance, capital resources, capital buffers, unencumbered assets and leverage. The EBA has been tasked with developing guidelines and technical standards during 2014 in relation to both general principles on disclosure and specific disclosure requirements. The Group’s 2014 year end disclosures will be required to comply with the new disclosure requirements and associated guidelines and technical standards in force at 31 December 2014.

Further details on the impact of CRD IV on the Group’s capital position can be found on pages 25 to 28.

DISCLOSURE POLICY

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

BASIS OF PREPARATION

This document contains the consolidated Pillar 3 disclosures of Lloyds Banking Group plc as at 31 December 2013, 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 2013 Lloyds Banking Group plc Annual Report and Accounts. As such, this document should be read in conjunction with the Annual Report and Accounts and, in particular, whenever the '❖' symbol appears in the document.

It is important to note that a number of significant differences exist between accounting disclosures published in accordance with International Financial Reporting Standards ('IFRS') and Pillar 3 disclosures published in accordance with prudential requirements, 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 on pages 14 to 17.

Throughout this document, unless otherwise specified, credit risk exposures are defined as the exposure at default **(EAD)**, prior to the application of credit risk mitigation. EAD is defined as the aggregate of drawn (on balance sheet) exposures, undrawn (off balance sheet) commitments and contingent liabilities, post application of credit conversion factors, and other relevant regulatory adjustments. Notable exceptions to this definition include securitisation positions, counterparty credit risk exposures and past due and impaired exposures. A summary, noting the definitions applied, is provided below.

Exposure Type	Definition Applied
Credit risk exposures (excluding securitisation positions)	EAD pre CRM [1]
Counterparty credit risk exposures	EAD post CRM
Securitisation positions	The aggregate of the Group's retained or purchased positions, excluding those positions rated below BB- or that are unrated and therefore deducted from capital.
Past due and impaired exposures	Accounting balance, defined in accordance with International Financial Reporting Standards

Notes

[1] For credit risk exposures risk weighted under the Standardised Approach, the EAD pre CRM value is stated net of individually assessed impairment provisions. Collectively assessed impairment provisions relating to Standardised credit risk exposures form part of tier 2 capital, subject to limits.

Individually and collectively assessed impairment provisions relating to credit risk exposures risk weighted under a relevant IRB Approach methodology are netted against expected losses as described on page 9.

FREQUENCY, MEDIA AND LOCATION

In accordance with Pillar 3 disclosure requirements 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/lloyds-banking-group/).

VERIFICATION

The disclosures presented within this document do not require to be subjected to an external audit. Instead, the disclosures have been verified and approved through internal governance procedures in line with the Group's Pillar 3 Disclosure Policy, including the review and approval of the disclosures by the Group's Disclosure Committee, Audit Committee and the Board following the receipt of attestations in respect of the both the quantitative and qualitative disclosures from Divisional Finance Directors, Risk Division Officers and other senior executives.

RISK PROFILE DISCLOSURE

In accordance with the requirements of BIPRU Chapter 11 and the Group's Pillar 3 Disclosure Policy, the Group is required to assess whether its external disclosures taken as a whole (including the Group's News Release, Annual Report and Accounts and Pillar 3 Disclosures) comprehensively portray its risk profile.

In this respect, the Group's Annual Report and Accounts provides an in depth analysis of the principal risks and emerging risks to which the Group is exposed, together with further detail on the Group's key risk drivers.

- The relevant analysis is presented in the following sections of the 2013 Lloyds Banking Group plc Annual Report and Accounts:
  - Risk overview, pages 40 to 43;
  - Emerging risks, page 126;
  - Risk drivers, page 133

The Group's Pillar 3 disclosures focus primarily on capital risk and the key risk drivers behind the Group's Pillar 1 capital requirements (i.e. credit, market and operational risks), providing granular information and analysis in addition to that presented within the Annual Report and Accounts.

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 accounting consolidation are also included within the scope of 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 may include joint ventures and associates, as defined under IFRS accounting standards, and specified venture capital investments. In certain circumstances, participations are deducted from capital rather than proportionally consolidated.

The assets of insurance undertakings are excluded from the calculation of consolidated capital requirements and consolidated capital resources. Investments in insurance undertakings are deducted from capital. The regulatory consolidation group diagram presented on page 15 highlights the key insurance undertakings of the Group that are excluded from the scope of regulatory consolidation.

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 2013 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 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, other than the constraints imposed over the available capital resources of the Group’s life assurance businesses.

❖ Further details on the constraints imposed are provided on page 189 of the Risk Management section of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

SUB GROUP DISCLOSURES

Limited additional disclosures surrounding the consolidated capital resources and consolidated capital requirements of Lloyds Bank plc ('Lloyds Bank Group') and Bank of Scotland plc ('BOS Group') have been provided within the appendices to this document in fulfilment of significant subsidiary disclosure requirements.

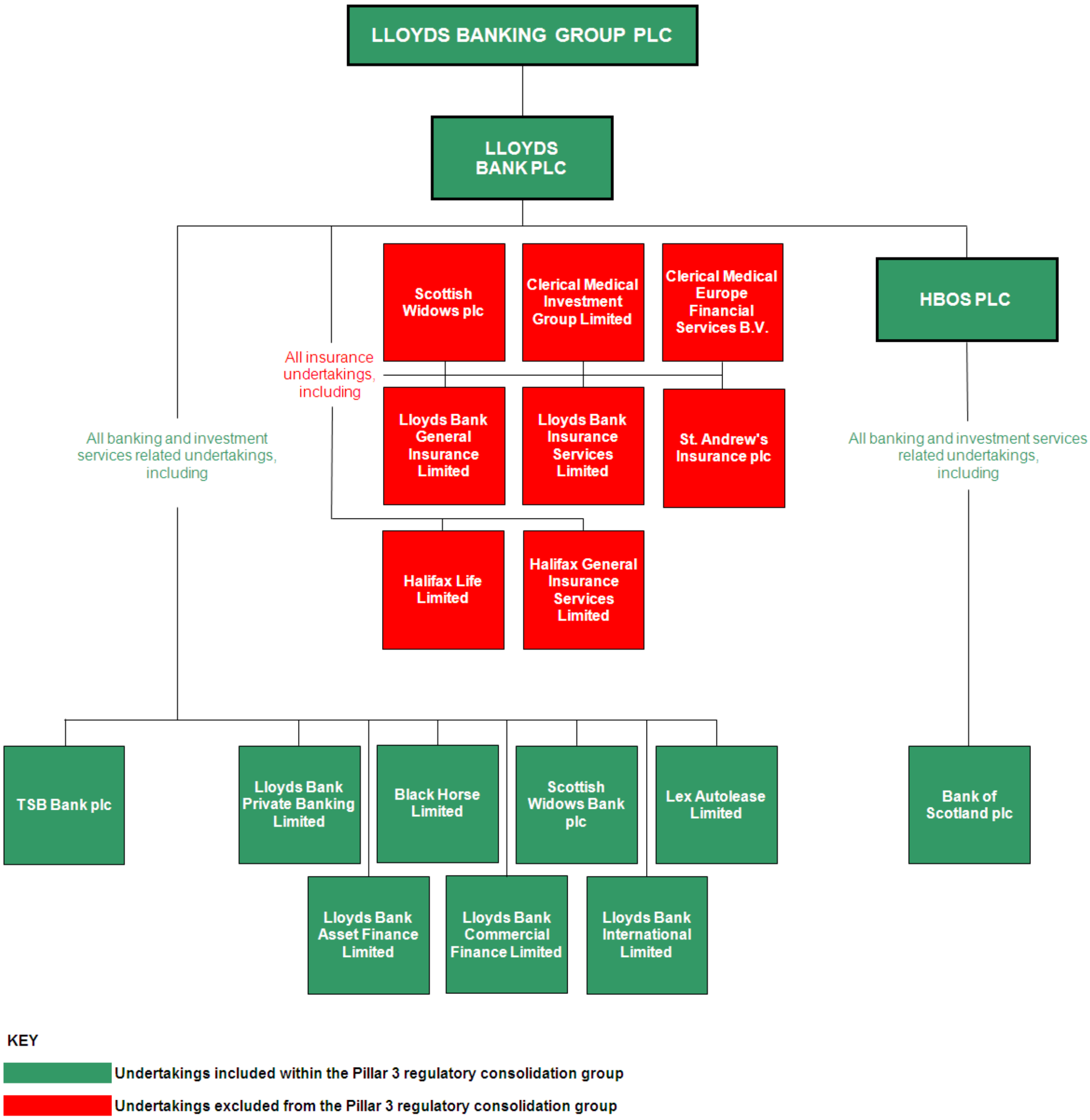
SOLO CONSOLIDATION

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 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 PRA approval and is performed in line with the terms established by the PRA for each individual bank.

REGULATORY CONSOLIDATION GROUP

A summarised diagrammatical representation (as at 31 December 2013) of the regulatory consolidation group upon which the disclosures presented within this document are based is provided below.



During the course of 2013 a number of significant transactions took place in respect of the Group's banking and investment services undertakings included within the scope of the regulatory consolidation group. These included several high profile business disposals, including the sale of the Group's Australian and Spanish operations, the announced disposal of the Group's investment in Sainsbury's Bank plc (a joint venture operation) and the announced disposal of Scottish Widows Investment Partnership Limited. In addition, the Group established TSB Bank plc to facilitate the divestment of part of the Group's branch network under European Commission state aid requirements.

The Group also disposed of holdings in several insurance undertakings during 2013, including the sale of the Group's remaining investment in St. James's Place plc and the announced disposal of Heidelberger Lebensversicherung A.G. These insurance undertakings did not at any point form part of the regulatory consolidation group during 2013. The Group's remaining insurance undertakings continue to be excluded from the scope of the regulatory consolidation group.

❖ Further details on the key business disposals that completed or that were announced during 2013 are provided on pages 13 and 236 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

❖ Further details on the establishment of TSB Bank plc during 2013 are provided on page 81 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

CONSOLIDATED BALANCE SHEET UNDER THE REGULATORY SCOPE OF CONSOLIDATION

The following table provides a reconciliation of the Group's consolidated balance sheet on an accounting consolidation basis (as presented on pages 206 to 207 of the 2013 Lloyds Banking Group plc Annual Report and Accounts) to the Group's consolidated balance sheet under the regulatory scope of consolidation.

Table 8: **Consolidated regulatory balance sheet**

Balance Sheet Category	Consolidated Accounting Balance Sheet	Deconsolidated Entities (Insurance / Other) [1]	Proportional Consolidation (Joint Ventures / Associates) [2]	Regulatory Reallocations [3]	Consolidated Regulatory Balance Sheet
	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	49,915	-	69	-	49,984
Items in the course of collection from banks	1,007	-	45	-	1,052
Treasury bills and other eligible bills	-	-	255	989	1,244
Trading and other financial assets at fair value through profit or loss	142,683	(100,307)	-	(42,376)	-
Derivative financial instruments	33,125	(807)	1	-	32,319
Reverse repurchase agreements and cash collateral on securities borrowed	-	-	104	30,017	30,121
Loans and advances to banks	25,365	(20,108)	423	1,515	7,195
Loans and advances to customers	495,281	(2,586)	1,385	114	494,194
Debt securities	1,355	1,787	169	56,565	59,876
Available-for-sale financial assets	43,976	1,646	-	(45,622)	-
Investment properties	4,864	(4,205)	-	(659)	-
Equity shares	-	-	-	1,169	1,169
Investment in group undertakings	-	5,854	(86)	270	6,038
Goodwill	2,016	-	-	-	2,016
Value of in-force business	5,335	(5,335)	-	-	-
Other intangible assets	2,279	(137)	2	-	2,144
Tangible fixed assets	7,570	(81)	9	659	8,157
Current tax recoverable	31	(96)	-	195	130
Deferred tax assets	5,104	(302)	-	1,355	6,157
Retirement benefit assets	98	-	-	-	98
Prepayments and accrued income	-	-	19	1,144	1,163
Other assets	27,026	(21,209)	6	(1,479)	4,344
Total Assets	**847,030**	**(145,886)**	**2,401**	**3,856**	**707,401**
Liabilities					
Deposits from banks	13,982	-	407	(1,874)	12,515
Customer deposits	441,311	2,594	1,752	(4,328)	441,329
Items in course of transmission to banks	774	-	1	-	775
Trading and other financial liabilities at fair value through profit or loss	43,625	-	-	(28,903)	14,722
Derivative financial instruments	30,464	(854)	3	-	29,613
Liabilities in respect of sale and repurchase agreements and cash collateral received for securities lent	-	-	-	35,105	35,105
Notes in circulation	1,176	-	-	-	1,176
Debt securities in issue	87,102	(2,001)	-	(30,667)	54,434
Covered bonds	-	-	-	30,667	30,667
Liabilities arising from insurance contracts and participating investment contracts	82,777	(82,777)	-	-	-
Liabilities arising from non-participating investment contracts	27,590	(27,590)	-	-	-
Unallocated surplus within insurance businesses	391	(391)	-	-	-
Other liabilities	40,607	(30,684)	104	(4,612)	5,415
Accruals and deferred income	-	-	33	4,612	4,645
Retirement benefit obligations	1,096	10	-	-	1,106
Current and deferred tax liabilities	150	(1,640)	5	1,485	-
Other provisions	4,337	(338)	41	2,371	6,411
Subordinated liabilities	32,312	(2,215)	55	-	30,152
Total Liabilities	807,694	(145,886)	2,401	3,856	668,065
Total Equity [4]	39,336	-	-	-	39,336
Total Equity and Liabilities	**847,030**	**(145,886)**	**2,401**	**3,856**	**707,401**

Notes

[1] As insurance undertakings are excluded from the scope of the Group's regulatory consolidation, assets and liabilities relating to the Group's insurance operations require to be removed from the regulatory balance sheet. Such undertakings are referred to as 'deconsolidated entities' and principally relate to the insurance operations of Scottish Widows Group (headed by Scottish Widows plc) whose principal activity is the undertaking of ordinary long-term insurance and savings business and associated investment activities. Investments in insurance undertakings are deducted from capital resources.

[2] In accordance with regulatory consolidation requirements, investments in joint ventures and associates (other than venture capital investments) are proportionally consolidated rather than accounted for under the equity method applied by the Group for statutory accounting purposes. These investments principally relate to Sainsbury's Bank plc, a joint venture banking operation. The Group's announced disposal of its investment in Sainsbury's Bank plc was completed post year end on 31 January 2014.

[3] Regulatory reallocations are made in accordance with PRA reporting requirements that require certain balances to be re-categorised. In particular, various balances categorised as trading and other financial assets or liabilities at fair value through profit or loss and available-for-sale financial assets are separated out for regulatory reporting purposes into their underlying asset or liability categories. The net difference arising is predominantly due to the reclassification of certain provisions, previously netted against asset balances, to liabilities on the regulatory balance sheet.

[4] A reconciliation of total equity to core tier 1 capital is presented on page 22.

REGULATORY BALANCE SHEET ASSETS TO GROSS DRAWN CREDIT RISK EXPOSURE

A reconciliation of consolidated regulatory balance sheet assets to gross drawn (on-balance sheet) credit risk exposures is presented in the table below.

Gross drawn credit risk exposures represent the most significant component of EAD, the definition of which is provided on page 12.

Table 9: **Gross drawn credit risk exposure**

Regulatory Balance Sheet Category	Consolidated Regulatory Balance Sheet Assets	Assets Deducted from Own Funds [1]	Assets Linked to Market Risk / Counterparty Credit Risk [2]	Other Regulatory Adjustments [3]	Gross Drawn Credit risk Exposures [4]
	£m	£m	£m	£m	£m
Cash and balances at central banks	49,984	-	-	(253)	49,731
Derivative financial instruments	32,319	-	(32,319)	-	-
Reverse repurchase agreements and cash collateral on securities borrowed	30,121	-	(30,121)	-	-
Loans and advances to banks and customers	501,389	-	(5,775)	10,872	506,486
Debt securities and eligible bills	61,120	(1,692)	(6,479)	(1,005)	51,944
Equity shares	1,169	-	-	-	1,169
Investment in group undertakings	6,038	(5,854)	-	(184)	-
Goodwill	2,016	(2,016)	-	-	-
Other intangible assets	2,144	(2,144)	-	-	-
Deferred tax assets	6,157	-	-	-	6,157
Retirement benefit assets	98	(98)	-	-	-
Other assets	14,846	-	-	(1,288)	13,558
Total	**707,401**	**(11,804)**	**(74,694)**	**8,142**	**629,045**

Notes

[1] Assets that are ultimately deducted from own funds, subsequent to regulatory adjustments applied.

[2] Assets, the underlying transactions of which, are subject to market risk or counterparty credit risk capital calculations.

[3] Other regulatory adjustments primarily consist of the grossing up of loans and advances to banks and customers as a result of the removal of related accounting allowances for impairment losses and adjustments to reflect specific regulatory treatments and valuation methodologies.

[4] The total credit risk exposure of £724.9bn presented on page 8 represents the sum of the total gross drawn credit risk exposure of £629.0bn presented above, credit converted off-balance sheet commitments and contingent liabilities, value adjustments (including the offset of individually assessed impairment provisions against Standardised Approach exposures) and further regulatory adjustments.

RISK MANAGEMENT

THE GROUP'S APPROACH TO RISK

The Group operates a prudent approach to risk with rigorous management controls to keep the Group safe, support sustainable business growth and minimise losses within risk appetite. The Group has a strong and independent risk function (Risk Division) with a mission to maintain a robust control framework, identify and escalate emerging risks and support sustainable business growth within risk appetite through good risk reward decisioning.

Risk Culture

The Board ensures that senior management implements risk policies and risk appetites that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the Group's risk profile.

The Group has a conservative business model embodied by a risk culture founded on a prudent approach to managing risk. The Group refreshed its Codes of Business and Personal Responsibility in 2013 reinforcing its approach where colleagues are accountable for the risks they take and the needs of customers are paramount.

The focus remains on building and sustaining long-term relationships with customers whatever the economic climate.

Risk as a Strategic Differentiator

The Group strategy and risk appetite were developed together to ensure one informed the other in creating a strategy that delivers on becoming the best bank for the Group's customers whilst helping Britain prosper and creating sustainable growth over time.

The Group believes effective risk management can be a strategic differentiator, in particular:

- **Sustainable growth**: The role of risk is to support the business in delivering sustainable growth, which is achieved through informed risk decision making and superior risk and capital management, supported by a consistent risk-focused culture across the Group.

- **Conservative approach to risk**: The Group has a fully embedded conservative approach to, and prudent appetite for, risk with risk culture and appetite driven from the top.

- **Strong control framework**: This framework is the foundation for the delivery of effective risk management as it ensures appropriate engagement in developing risk appetite and that business units operate within approved parameters.

- **Effective risk analysis, management and reporting**: This identifies opportunities as well as risks and ensures risks are managed appropriately and consistently with strategy. The Group's principal risks and performance against risk appetite are monitored and reported regularly to senior management using quantitative and qualitative analysis and are subject to relevant stress testing. This enables the Group to understand the risk in the business at both an individual risk type and aggregate portfolio level.

- **Business focus and accountability**: Managing risk effectively is a key focus and is one of the five criteria within the Group Balanced Scorecard on which business areas and individual performance are judged. The Group's approach to risk means that businesses remain accountable for risk but a strong and independent risk function also helps ensure adherence to the Group's risk and control frameworks. Continued investment in risk systems and processes will also help differentiate the Group's risk management approach.

Risk Appetite

- The Group defines risk appetite as 'the amount and type of risk that our organisation is prepared to seek, accept or tolerate'.

- The Group's strategy operates in tandem with its high level risk appetite which is supported by more detailed metrics and limits. An updated Risk Appetite Statement was approved by the Board in 2013. This incorporated recommendations from the Non-Executive Directors and is fully aligned with Group strategy.

- Risk appetite is embedded within principles, policies, authorities and limits across the Group.

- Risk appetite will continue to evolve to reflect external market developments and the composition of the Group.

- The Group optimises performance by allowing business units to operate within approved risk appetite and limits.

Governance and Control

- Governance is maintained through delegation of authority from the Board down through the management hierarchy, supported by a committee-based structure designed to ensure open challenge and that the Group's risk appetite, principles, policies, procedures, controls and reporting are fully in line with regulations, law, corporate governance and industry good-practice.

- 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 promptly escalated and remediation plans are initiated where required.

- The Group's approach to risk is founded on a robust control framework and a strong risk management culture which ensures that business units remain accountable for risk and therefore guides the way all employees approach their work, behave and make decisions.

- The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by both the Board and senior management.

- A strong control framework remains a priority for the Group and is the foundation for the delivery of effective risk management.

Risk Decision Making and Reporting

- Taking risks which are well understood, consistent with strategy and with appropriate margin is a key driver of shareholder value.

- Risk analysis and reporting supports the identification of opportunities as well as risks.

- An aggregate view of the Group's overall risk profile, key risks and management actions, and performance against risk appetite, is reported to and discussed monthly at the Group Risk Committee (and as a subset at the Group Asset and Liability Committee), with regular reporting to the Board Risk Committee and the Board.

- Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities to inform strategic planning.

- The Chief Risk Officer regularly informs the Board Risk Committee (BRC) of the aggregate risk profile and has direct access to the Chairman and members of the Board Risk Committee. The Chief Risk Officer was appointed to the Board on 29 November 2013.

❖ Details of the Group's application of stress testing, the methodologies applied, use of reverse stress testing and governance are presented in the Risk Management section of the 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 127 to 128.

❖ Further details on the Group's risk governance are presented in the Risk Management section of the 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 129 to 132.

❖ Further details on the Group's risk management processes in relation to the key risk drivers that do not fall under the scope of the Group's Pillar 3 disclosures are presented in the Risk Management section of the 2013 Lloyds Banking Group plc Annual Report and Accounts, as follows:

  - Conduct risk, page 163;
  - Funding and liquidity risk, pages 171 to 177;
  - Capital risk (life insurance businesses), pages 187 to 191;
  - Regulatory risk, page 192;
  - Insurance risk, page 193;
  - People risk, page 194;
  - Financial reporting risk, page 195;
  - Governance risk, page 196.

CAPITAL RESOURCES

CAPITAL RISK

Definition

Capital risk is defined as the risk that the Group has a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group.

Risk Appetite

Capital risk appetite is set by the Board, reflecting the Group's strategic plans, regulatory capital constraints and market expectations. It includes a number of minimum capital ratios in normal and stressed conditions as well as a specific measure for the Insurance business, set by the Insurance Board, taking account of the need to maintain regulatory solvency including appropriate management buffers. The Board and the Group Chief Executive, assisted by the Group Asset and Liability Committee and the Group Risk committee, regularly review performance against the risk appetite. A key metric is the Group's common equity tier 1 ('CET1') capital ratio which the Group currently aims to maintain in excess of 10 per cent.

Exposure

A capital exposure arises where the Group has insufficient 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 maintaining sufficient capital resources to prevent such exposures while optimising value for shareholders.

Measurement

The Group measures the amount of capital it holds using the regulatory framework. From 1 January 2014 this included the new Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulatory Authority policy statement PS7/13. Prior to this date, and for the purposes of determining the Group's capital resources and requirements at 31 December 2013, these have been based upon the modified Basel II framework as implemented by the PRA.

As part of the capital planning process, capital positions are subjected to extensive stress analysis to determine the adequacy of the Group's capital resources against the minimum requirements, including Individual Capital Guidance ('ICG'), over the forecast period. The outputs from some of these stress analyses are used by the PRA to set a Capital Planning Buffer ('CPB') for the Group. This comprises a minimum level of capital buffers over and above the minimum regulatory requirements that should be maintained in non-stressed conditions as mitigation against potential future periods of stress.

The PRA requires the ICG and the CPB to remain confidential between the bank and the PRA.

Mitigation

The Group has a capital management framework including policies and procedures that are designed to ensure that it operates within its risk appetite, continues to comply with regulatory requirements and is positioned to meet anticipated future changes to its capital requirements.

The Group is able to accumulate additional capital through profit retention, by raising equity via, for example, a rights issue or debt exchange and by raising tier 1 and tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting its lending strategy, risk hedging strategies and through business disposals. If necessary, this can include limiting new business.

Additional measures to manage the Group's capital position include seeking to strike an appropriate balance of capital held within its insurance and banking subsidiaries and through improving the quality of its capital through liability management exercises.

Monitoring

Capital is actively managed and regulatory ratios are a key factor in the Group's planning processes and stress analyses. Five year forecasts of the Group's capital position, based upon the Group's operating plan, are produced at least annually to inform the Group's capital strategy whilst shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan. The capital plans are tested for capital adequacy using a range of stress scenarios covering adverse economic conditions as well as other adverse factors that could impact the Group and the Group maintains a Recovery Plan which sets out a range of potential mitigating actions that could be taken in response to a stress.

Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios, including those in stressed scenarios, is undertaken, including submissions to the Group Asset and Liability Committee, the Group Risk Committee, Board Risk Committee and the Board.

The regulatory framework within which the Group operates continues to be enhanced as part of the global banking reforms.

Over the course of 2013 there have been significant regulatory developments in the area of capital and the related management. The principal changes relate to the finalisation of CRD IV and subsequent consultation and finalisation of PRA requirements for their implementation in the UK and the 2013 announcement that major UK banks are expected to meet specific targets on an adjusted basis for CET1 and leverage ratios. The Group notes the final statements from the PRA on the implementation of capital requirements in the UK and will continue to work with the regulator to ensure that the Group continues to meet the regulator's capital expectations. The Group continuously evaluates the efficiency of its capital structure, management of which may result in significant one-off charges or gains, and its capital structure's alignment with the regulatory framework. With the adoption of CRD IV, the Group is considering opportunities to raise new Additional tier 1 securities which would rank senior to ordinary shares, and be automatically convertible into ordinary shares if the Group's common equity tier 1 ratio fell below a specified trigger point.

Beyond CRD IV there have been a number of draft technical standards issued for consultation which relate to both capital and leverage and both Basel and European regulatory bodies continue to develop their thinking on both capital resources and capital requirement measures. Within the UK the PRA have been active in requiring enhanced capital standards and encouraging further disclosure developments and HM Treasury have been consulting on practical aspects of the application of a counter cyclical buffer.

The Group monitors these developments very closely, participating actively in the regulatory consultation processes and analysing the potential financial impacts to ensure that the Group continues to have a strong loss absorption capacity that exceeds the regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Capital Management in 2013

The Group made significant progress in further strengthening its capital position in 2013 through its strongly capital generative strategy, including capital-efficient profit generation in the core business, the release of capital through non-core asset disposals and the successful delivery of management actions.

- Core tier 1 ratio, based on the capital regulations as at 31 December 2013, increased 2.0 percentage points from 12.0 per cent to 14.0 per cent.

- Pro forma fully loaded CET1 ratio under the CRD IV rules increased 2.2 percentage points from 8.1 per cent to 10.3 per cent whilst the ratio excluding proforma impacts increased to 10.0 per cent.

- Pro forma fully loaded CRD IV leverage ratio including tier 1 instruments is 4.1 per cent and is 3.4 per cent when including only CET1 capital resources. Excluding the pro forma impacts, the fully loaded ratio including tier 1 instruments was 4.0 per cent and 3.4 per cent when including only CET1 capital resources.

- Under the January 2014 revised Basel lll leverage ratio framework, the Group's fully loaded leverage ratio is estimated to improve significantly to 4.5 per cent on a proforma basis including tier 1 instruments, and 3.8 per cent including only CET1 capital resources.

Capital Position at 31 December 2013

The Group's capital position applying prevailing rules as at 31 December 2013, is set out in the following section. Additionally, information about the Group's capital position on a CRD IV basis is set out on pages 25 to 28.

LLOYDS BANKING GROUP CAPITAL RESOURCES

The capital resources of the Group as at 31 December 2013 are presented in the table below.

Table 10: **Capital resources**

		2013		2012 [3]
	£m	£m	£m	£m
Core tier 1				
Shareholders' equity per balance sheet		38,989		43,999
Non-controlling interests per balance sheet		347		685
Regulatory adjustments:				
Regulatory adjustments to non-controlling interests		(315)		(628)
Adjustment for own credit		185		217
Defined benefit pension adjustment		(78)		(1,438)
Unrealised reserve on available-for-sale debt securities		750		(343)
Unrealised reserve on available-for-sale equity investments		(135)		(56)
Cash flow hedging reserve		1,055		(350)
Other items		452		33
		41,250		42,119
Less: deductions from core tier 1				
Goodwill		(2,016)		(2,016)
Intangible assets		(1,799)		(2,091)
50% excess of expected losses over impairment provisions		(373)		(636)
50% of securitisation positions		(71)		(183)
Core tier 1 capital		36,991		37,193
Non-controlling preference shares [1]		1,060		1,568
Preferred securities [1]		3,982		4,039
Less: deductions from tier 1				
50% of material holdings		(3,859)		(46)
Total tier 1 capital		38,174		42,754
Total tier 1 capital (excluding preferred securities) [2]	*34,192*		*38,715*	
Tier 2				
Undated subordinated debt		1,825		1,828
Dated subordinated debt		18,567		19,886
Unrealised gains on available-for-sale equity investments		135		56
Eligible provisions		359		977
Less: deductions from tier 2				
50% excess of expected losses over impairment provisions		(373)		(636)
50% of securitisation positions		(71)		(183)
50% of material holdings		(3,859)		(46)
Total tier 2 capital		16,583		21,882
Total tier 2 capital (including preferred securities) [2]	*20,565*		*25,921*	
Supervisory deductions				
Unconsolidated investments – life		-		(10,104)
Unconsolidated investments – general insurance and other		-		(929)
Total supervisory deductions		-		(11,033)
Total Capital Resources		54,757		53,603
Risk Weighted Assets		263,850		310,299
Core tier 1 capital ratio (%)		14.0%		12.0%
Tier 1 capital ratio (%)		14.5%		13.8%
Total capital ratio (%)		20.8%		17.3%

Notes

[1] Non-controlling preference shares and preferred securities represent the Group's hybrid capital securities. These are included within tier 1 capital in accordance with grandfathering provisions (GENPRU TP 8A).

[2] The disclosure of tier 1 capital excluding preferred securities and tier 2 capital including preferred securities has been produced to meet the disclosure requirements of BIPRU Chapter 11. The ordinary presentation of preferred securities within tier 1 capital has been maintained in the second and fourth columns as this reflects the disclosure adopted within the 2013 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 ordinary treatment of preferred securities.

[3] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

MOVEMENTS IN CAPITAL

The movements in core tier 1, tier 1, tier 2 and total capital in the period are shown below.

Table 11: **Movements in capital**

	Core Tier 1 £m	Tier 1 £m	Tier 2 £m	Supervisory Deductions £m	Total Capital £m
At 31 December 2012 [1]	37,193	5,561	21,882	(11,033)	53,603
Loss attributable to ordinary shareholders	(838)	-	-	-	(838)
Share issuance	510	-	-	-	510
Pension movements:					
Implementation of IAS 19R[2]	(1,258)				(1,258)
Deduction of pension asset	515	-	-	-	515
Movement through other comprehensive income	(108)	-	-	-	(108)
Goodwill and intangible assets deductions	292	-	-	-	292
Excess of expected losses over impairment allowances	263	-	263	-	526
Change in treatment of material holdings	-	(5,517)	(5,516)	11,033	-
Material holdings deduction	-	1,704	1,703	-	3,407
Eligible provisions	-	-	(618)	-	(618)
Subordinated debt movements:					
Foreign exchange	-	40	98	-	138
Repurchases, redemptions, amortisation and other	-	(605)	(1,420)	-	(2,025)
Other movements	422	-	191	-	613
At 31 December 2013	36,991	1,183	16,583	-	54,757

Notes

[1] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Includes the impact to other comprehensive income and movement in the retirement benefit asset.

Core tier 1 capital resources have decreased by £202m in the period largely driven by movements relating to defined benefit pension schemes and attributable loss, partially offset by share issuances and reductions in excess expected losses and intangible assets. The movements relating to pension schemes primarily reflect the impact of the adoption of amendments to IAS 19, whereby valuation impacts relating to Group defined benefit schemes flow through other comprehensive income, partially offset by a reduction in the regulatory deduction of the defined benefit pension scheme asset.

Tier 1 and tier 2 capital resources have reduced primarily due to the reallocation of unconsolidated investments in Life and General Insurance businesses, which were previously deducted as supervisory deductions from total capital, to become deductions from tier 1 capital (50 per cent of the total) and tier 2 capital (also 50 per cent).

The material holdings deduction from capital, predominantly relating to the Group’s investment in its Insurance businesses, has reduced by £3,407m during the period reflecting payment by the Insurance businesses to the banking group of dividends totalling £2,155m, elements of the Group’s subordinated debt holdings in the Insurance business that have been repaid following the issuance of external subordinated debt in the period and the disposal of the Group’s holding in St. James’s Place.

CAPITAL SECURITIES

Summary information on the terms and conditions attached to capital securities (subordinated liabilities and share capital) issued by the Group is presented in the Notes to the Consolidated Financial Statements of the Group’s Annual Report and Accounts as follows:

- Note 44 (Subordinated liabilities), 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 284 to 288
- Note 45 (Share capital), 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 289 to 290

As at 31 December 2013, the recognition, classification and valuation of these securities within the Group's regulatory capital resources were subject to the requirements of the prevailing GENPRU rules. This can lead to a different treatment from the IFRS accounting approach upon which the disclosures within the Annual Report and Accounts are based. For subordinated liabilities differences can arise in the treatment of fair value hedge accounting adjustments, accrued interest and regulatory requirements surrounding amortisation of dated securities. In addition, securities issued by the Group's insurance subsidiaries (primarily Scottish Widows plc and Clerical Medical Finance plc) are excluded from the regulatory capital resources of the banking group.

In accordance with grandfathering provisions established under the CRD II package of amendments, the Group recognises both its preference share capital and preferred securities as forms of hybrid capital securities. These are included within tier 1 capital, subject to the required regulatory adjustments. In accordance with the requirements of GENPRU Transitional Provision (‘TP’) 8.5, the 6.90% Perpetual Capital Securities (US$1,000 million) are recognised as perpetual non-cumulative preference shares for regulatory capital purposes.

- Further detail on the Group’s preference share capital and preferred securities is provided on pages 284 to 285 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

The implementation of CRD IV will result in further changes to the recognition and treatment of hybrid capital securities and related grandfathering provisions.

All preferred securities included an incentive at issuance for the firm to redeem them, except for the 6.85% Non-cumulative Perpetual Preferred Securities (US$1,000 million) and the 6.90% Perpetual Capital Securities (US$1,000 million) noted above.

❖ Full details on the Group's tier 2 capital securities (undated subordinated liabilities, Enhanced Capital Notes and dated subordinated liabilities) are provided on pages 286 to 288 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

A list of those tier 2 capital securities disclosed that included an incentive at issuance for the firm to redeem them is provided below. Note that this excludes securities issued by insurance subsidiaries.

Table 12: **Subordinated liabilities with an incentive to redeem**

Undated subordinated liabilities with an incentive for the firm to redeem them included at issuance [1]	Dated subordinated liabilities with an incentive for the firm to redeem them included at issuance [1]
• 6.625% Undated Subordinated Step-up Notes (£410 million)	• Subordinated Step-up Floating Rate Notes 2016 (£300 million)
• 5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	• Subordinated Step-up Floating Rate Notes 2016 (€500 million)
• 6.5% Undated Subordinated Step-up Notes callable 2019 (£270 million)	• Callable Floating Rate Subordinated Notes 2016 (€500 million)
• 8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	• Callable Floating Rate Subordinated Notes 2016 (€500 million)
• 6.5% Undated Subordinated Step-up Notes callable 2029 (£450 million)	• Subordinated Callable Notes 2016 (US$750 million)
• 6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	• Subordinated Callable Notes 2017 (€1,000 million)
• 5.625% Cum. Call. Fixed to Floating Rate Undated Sub. Notes callable 2019 (£500m)	• Subordinated Callable Notes 2017 (US$1,000 million)
• 4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)	• Subordinated Callable Floating Rate Instruments 2017 (Aus$400m)
• Floating Rate Undated Subordinated Notes (€500 million)	• 6.75% Sub. Call. Fixed to Floating Rate Instruments 2017 (Aus$200m)
• 5.125% Undated Subordinated Fixed to Floating Notes (€750 million)	• 5.109% Callable Fixed to Floating Rate Notes 2017 (Can$500 million)
• 5.75% Undated Subordinated Step-up Notes (£600 million)	• 6.305% Sub. Call. Fixed to Floating Rate Notes 2017 (£500 million)
• 6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	• 4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)
• 7.5% Undated Subordinated Step-up Notes (£300 million)	• 6.9625% Call. Sub. Fixed to Floating Rate Notes 2020 callable 2015 (£750 million)
• Floating Rate Undated Subordinated Step-up Notes (€300 million)	• 5.75% Subordinated Fixed to Floating Rate Notes 2025 callable 2020 (£350 million)
• 10.25% Subordinated Undated Instruments (£100 million)	• 4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)
• 5.75% Undated Subordinated Step-up Notes (£500 million)	
• 7.375% Subordinated Undated Instruments (£150 million)	

Notes

[1] The notes provided on page 286 and page 288 of the 2013 Lloyds Banking Group plc Annual Report and Accounts provide further details on the terms and conditions attached to these securities.

In addition to the above, there are two Enhanced Capital Notes ('ECNs') with an incentive for the firm to redeem them included at issuance. These are the 8% Fixed to Floating Rate Undated Enhanced Capital Notes callable 2020 (US$1,259 million) and the 8.5% Undated Enhanced Capital Notes callable 2021 (US$277 million).

❖ Further detail on the Group's Enhanced Capital Notes is provided on page 287 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

The following table compares the IFRS accounting value of subordinated liabilities recognised through tier 1 and tier 2 capital to the GENPRU regulatory equivalent.

Table 13: **Value of subordinated liabilities**

Tier / Capital Security	2013 IFRS £m	2013 GENPRU £m	2012 IFRS £m	2012 GENPRU £m
Tier 1 capital				
Non-controlling preference shares	1,085	1,060	1,599	1,568
Preferred securities	4,092	3,982	4,180	4,039
Tier 2 capital				
Undated subordinated debt	1,860	1,825	1,882	1,828
Dated subordinated debt	23,028	18,567	25,396	19,886
Total Subordinated Liabilities [1]	30,065	25,434	33,057	27,321

Notes

[1] Excludes securities issued by Scottish Widows plc and Clerical Medical Finance plc.

CRD IV CAPITAL AND LEVERAGE RATIO INFORMATION

The data in the following tables represents estimates reflecting the Group's interpretation of the CRD IV rules published on 27 June 2013 via the Official Journal of the European Union (including amendments made to the Regulation via the Corrigenda published on 30 November 2013) and the PRA policy statement PS7/13 issued on 19 December 2013. The actual capital ratios under CRD IV may differ as the final rules are assessed in their entirety, related technical standards are finalised and other guidance is issued by the relevant regulatory bodies.

A number of final draft CRD IV implementing and regulatory technical standards have already been issued by the European Banking Authority (EBA) with a number of other draft standards currently being taken through respective consultation processes. The Group has not reflected the impact of these draft standards in its CRD IV estimates, though it does not currently believe that these would make a material difference to the capital position outlined below.

A further detailed breakdown and analysis of the Group's CRD IV capital position under transitional and fully loaded requirements, produced in accordance with draft EBA proposals on the disclosure of capital under CRD IV, is provided in Appendix 1.

Capital Position on a CRD IV basis

The Group's capital position at 31 December 2013 is shown in the table below calculated on the following three bases; firstly the current prevailing regulatory framework; secondly applying the CRD IV rules including the transitional arrangements that have been in place from 1 January 2014; and thirdly on a fully loaded basis.

The transitional arrangements reflect the requirements of policy statement PS7/13, issued by the PRA on 19 December 2013. This differs from the Group's previously published statements, which allowed for the transitional phasing of CET1 deductions consistent with the FSA's previous policy guidance. This has resulted in a material reduction in the transitional CET1 capital bringing this close to the fully loaded position.

Table 14: **Capital position on a CRD IV basis**

31 December 2013	Prevailing rules as at 31 Dec 2013	CRD IV Rules: Transitional CRD IV Rules	CRD IV Rules: Fully Loaded CRD IV Rules
	£m	£m	£m
Core / common equity tier 1 (CET1)			
Shareholders' equity per balance sheet	38,989	38,989	38,989
Adjustment for insurance equity [1]	-	(1,917)	(1,917)
Regulatory adjustments:			
Non-controlling interests	32	-	-
Unrealised reserves on available-for-sale assets	615	-	-
Other adjustments	1,614	1,295	1,295
	41,250	38,367	38,367
Less: deductions from core / common equity tier 1			
Goodwill and other intangible assets [1]	(3,815)	(1,979)	(1,979)
Excess of expected losses over impairment provisions	(373)	(866)	(866)
Securitisation deductions	(71)	(141)	(141)
Significant investments [1]	-	(2,909)	(3,185)
Deferred tax assets	-	(5,025)	(5,155)
Core / common equity tier 1 capital	36,991	27,447	27,041
Proforma core / common equity tier 1 capital [2]	n/a	28,218	27,925
Additional tier 1 (AT1)			
Additional tier 1 instruments	5,042	4,486	-
Less: deductions from tier 1			
Significant investments	(3,859)	(677)	-
Total tier 1 capital	38,174	31,256	27,041
Proforma total tier 1 capital [2]	n/a	32,027	27,925
Tier 2			
Tier 2 instruments	20,392	19,870	15,636
Unrealised gains on available-for-sale equity investments	135	-	-
Eligible provisions	359	349	349
Less: deductions from tier 2			
Excess of expected losses over impairment provisions	(373)	-	-
Securitisation deductions	(71)	-	-
Significant investments	(3,859)	(1,015)	(1,692)
Total Capital Resources	54,757	50,460	41,334
Proforma Total Capital Resources [2]	n/a	51,231	42,218
Risk Weighted Assets	263,850	272,092	271,078
Proforma Risk Weighted Assets [2]	n/a	272,641	271,908
Core / common equity tier 1 capital ratio (%)	14.0%	10.1%	10.0%
Tier 1 capital ratio (%)	14.5%	11.5%	10.0%
Total capital ratio (%)	20.8%	18.5%	15.2%
Proforma core / common equity tier 1 capital ratio (%) [2]	n/a	10.3%	10.3%
Proforma tier 1 capital ratio (%) [2]	n/a	11.7%	10.3%
Proforma total capital ratio (%) [2]	n/a	18.8%	15.5%
31 December 2012 [3]			
Risk Weighted Assets	310,299	322,468	321,097
Core / common equity tier 1 capital ratio (%)	12.0%	11.6%	8.1%
Tier 1 capital ratio (%)	13.8%	11.6%	8.1%
Total capital ratio (%)	17.3%	16.7%	11.3%

Notes

[1] Removal of post-acquisition reserves impacts for Insurance business as under CRD IV, as implemented by PRA policy statement PS7/13, the deduction for significant investments in the equity of financial sector entities is based on cost of investment where previously this was based on net asset value. The overall impact of this change on the CRD IV ratios is negligible.

[2] Includes the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

[3] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

The movements in the transitional CRD IV common equity tier 1, tier 1, tier 2 and total capital positions in the period are shown below.

Table 15: **Movements in capital (CRD IV)**

	Common Equity Tier 1 £m	Additional Tier 1 £m	Tier 2 £m	Total Capital £m
At 31 December 2012 [1]	37,385	-	16,424	53,809
Update to transitional phasing and treatment of insurance	(10,979)	3,846	2,748	(4,385)
Loss attributable to ordinary shareholders	(838)	-	-	(838)
Share issuance	510	-	-	510
Pension movements:				
Implementation of IAS19R [2]	(1,258)			(1,258)
Deduction of pension asset	515	-	-	515
Movement through other comprehensive income	(108)	-	-	(108)
Available-for-sale reserve	(1,014)	-	-	(1,014)
Deferred tax asset	82	-	-	82
Goodwill and intangible assets deductions	292	-	-	292
Excess of expected losses over impairment allowances	406	-	-	406
Significant investment deduction	2,075	486	729	3,290
Eligible provisions	-	-	349	349
Subordinated debt movements:				
Grandfathering [3]	-	(557)	172	(385)
Restructuring to ensure CRD IV compliance	-	-	932	932
Foreign exchange	-	(49)	(102)	(151)
Repurchases, redemptions and other	-	83	(2,048)	(1,965)
Other movements	379	-	-	379
At 31 December 2013	27,447	3,809	19,204	50,460
Proforma impacts [4]	771	-	-	771
Proforma at 31 December 2013 [4]	28,218	3,809	19,204	51,231

Notes

[1] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

[2] Includes the impact to other comprehensive income and the movement in the retirement benefit asset.

[3] Includes movement from 90 per cent to 80 per cent grandfathering and adjustment due to further clarification of grandfathering rules.

[4] Includes the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

Common equity tier 1 capital resources have decreased by £9,938m in the period, £9,167m on a pro forma basis. This is substantially due to a £10,979m adjustment relating to updated transitional phasing, reflecting PRA policy statement PS7/13 which has accelerated the phasing in of deductions (including deferred tax, significant investments and excess expected losses) to CET1 bringing this close to the fully loaded position. Movements in CET1 capital include those reflected under prevailing rules at 31 December 2013 on page 23. Incremental to these are increases largely driven by the £2,155m in dividends from the Insurance business partially offset by negative valuation movements on available for sale assets.

Total capital resources have decreased by £3,349m in the period, £2,578m on a pro forma basis. Excluding the impact of updated transitional phasing, total capital increased by £1,036m, largely reflecting movements in CET1 resources described above.

Leverage Ratio

The Basel III reforms include the introduction of a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure. The leverage ratio is defined as tier 1 capital divided by the exposure measure. The Basel Committee will test the proposed 3 per cent minimum requirement for the leverage ratio and have proposed that final calibrations, and any further adjustments to the definition of the leverage ratio will be completed by 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018.

In line with previous reporting periods, the PRA has asked the Group to publish a leverage ratio on a fully loaded CRD IV basis, with the exposure measure adjusted to reflect the basis of the original December 2010 Basel III leverage ratio framework, as interpreted through guidance released in July 2012.

In addition to the calculation basis specified by the PRA, the Group's leverage ratio at 31 December 2013 is shown in the table below on a final CRD IV rules basis and estimated in accordance with the revised Basel III leverage ratio framework issued on 12 January 2014. In each case the ratio is presented on a 'transitional', 'fully loaded' and 'fully loaded including tier 1 instruments' basis. The inclusion of tier 1 instruments for the latter basis refers to the full recognition of tier 1 instruments that will become ineligible once the transitional phase has elapsed.

Table 16: **Leverage ratio on a CRD IV basis**

31 December 2013	Transitional	Fully Loaded	Fully Loaded (including tier 1 instruments) [1]
	£m	£m	£m
CRD IV rules			
Tier 1 capital			
Common equity tier 1 capital	27,447	27,041	27,041
Tier 1 subordinated debt	4,486	-	5,042
Tier 1 deductions	(677)	-	-
Total tier 1 capital	31,256	27,041	32,083
Proforma total tier 1 capital [2]	32,027	27,925	32,967
Exposures measure			
Total statutory balance sheet assets	847,030	847,030	847,030
Adjustment for insurance assets	(84,302)	(83,401)	(83,401)
Removal of accounting values for derivatives and securities financing transactions	(61,686)	(61,686)	(61,686)
Exposure value for derivatives	24,598	24,598	24,598
Exposure value for securities financing transactions	6,700	6,700	6,700
Off-balance sheet items	79,927	79,927	79,927
Other regulatory adjustments	(10,308)	(10,437)	(10,437)
Total exposures	801,959	802,731	802,731
Proforma total exposures [2]	809,090	813,055	813,055
Leverage ratio (%)	3.9%	3.4%	4.0%
Proforma leverage ratio (%) [2]	4.0%	3.4%	4.1%
Leverage ratio at 31 December 2012 [3]	4.4%	3.1%	3.8%
Basel III December 2010 rules [4]			
Leverage ratio (%)		3.3%	3.9%
Proforma leverage ratio (%) [2]		3.4%	4.0%
Basel III January 2014 rules [5]			
Leverage ratio (%)		3.7%	4.4%
Proforma leverage ratio (%) [2]		3.8%	4.5%

Notes

[1] Includes the full value of tier 1 instruments reported under the prevailing rules as at 31 December 2013. These instruments will become ineligible for inclusion in tier 1 capital over the transitional period.

[2] Includes the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

[3] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS19R and IFRS10.

[4] Exposure measure determined in accordance with the original December 2010 Basel III leverage ratio framework as interpreted through the July 2012 Basel III Quantitative Impact Study instructions and related guidance and as required by the PRA.

[5] Exposure measure estimated in accordance with the January 2014 revised Basel III leverage ratio framework.

In order to ensure that the capital and exposure components of the ratio are measured consistently CRD IV requires the assets of the insurance entities included in the Group's statutory consolidated balance sheet to be excluded from the exposure measure in proportion to the element of the investment in the Group's insurance businesses that is excluded from tier 1 capital. Under the January 2014 revised Basel III leverage ratio framework only the proportion of the investment in the Group's Insurance businesses not deducted from tier 1 capital is included in the exposure measure.

Leverage ratio exposure values for derivatives and securities financing transactions have been calculated in accordance with the methodologies prescribed by the relevant rules applied.

Off-balance sheet items primarily consist of undrawn credit facilities, including facilities that may be cancelled unconditionally at any time without notice. The leverage ratio exposure value for off-balance sheet items is determined by applying set credit conversion factors to the nominal values of the items, based on the classification of the item. On a CRD IV basis a credit conversion factor of 10 per cent is applied to unconditionally cancellable items, with remaining off-balance sheet items predominantly attracting a 100 per cent credit conversion factor. Under the January 2014 revised Basel III leverage ratio framework, the credit conversion factors applied to off-balance sheet items follow those prescribed by Standardised credit risk rules, subject to a floor of 10 per cent.

Other regulatory adjustments consist of other balance sheet assets that are required under CRD IV to be deducted from tier 1 capital. The removal of these assets from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

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 2013 are presented in the table below together with key drivers behind risk weighted asset movements. Notes in relation to the references below can be found on page 31.

Table 17: **Capital requirements**

(All figures are in £m)	2013 Risk Weighted Assets	2013 Pillar 1 Capital Requirements	2012 Risk Weighted Assets	2012 Pillar 1 Capital Requirements
CREDIT RISK				
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate - Main	48,771	3,902	54,835	4,387
Corporate - SME	10,570	846	12,628	1,010
Corporate - Specialised lending	100	8	5,368	429
Central governments and central banks	1,579	126	1,437	115
Institutions	1,339	107	1,447	116
Retail IRB Approach				
Retail - Residential mortgages	52,513	4,201	56,527	4,522
Retail - Qualifying revolving retail exposures	16,355	1,308	17,261	1,381
Retail - Other retail	13,671	1,094	15,206	1,216
Retail - SME	2,600	208	2,451	196
Other IRB Approaches [1]				
Corporate - Specialised lending	20,511	1,641	4,897	392
Equities - Exchange traded	307	24	248	20
Equities - Private equity	5,140	411	4,917	393
Equities - Other	455	36	544	44
Securitisation positions [2]	3,319	266	6,687	535
Total - IRB Approach	177,230	14,178	184,453	14,756
Exposures subject to the Standardised Approach				
Central governments and central banks	49	4	105	9
Regional governments or local authorities	-	-	18	1
Administrative bodies and non-commercial undertakings	9	1	62	5
Multilateral development banks	-	-	-	-
Institutions	295	24	566	45
Corporates	16,974	1,358	25,537	2,043
Retail	4,023	322	5,604	448
Secured by mortgages on residential property	2,535	203	6,950	556
Secured by mortgages on commercial real estate	206	16	15,200	1,216
Past due items	2,742	219	6,218	498
Items belonging to regulatory high risk categories	1	-	1	-
Short term claims on institutions or corporates	830	66	187	15
Collective investment undertakings	49	4	53	4
Other items [3]	13,437	1,075	13,164	1,053
Total - Standardised Approach	41,150	3,292	73,665	5,893
Total Credit Risk	218,380	17,470	258,118	20,649
COUNTERPARTY CREDIT RISK				
IRB Approach	7,082	566	6,162	493
Standardised Approach	712	57	6,686	535
Total Counterparty Credit Risk	7,794	623	12,848	1,028
MARKET RISK				
Internal Models Approach	9,031	723	9,316	746
Standardised Approach				
Interest rate position risk requirement	1,557	125	1,719	138
Foreign currency position risk requirement	341	27	291	23
Equity position risk requirement	11	1	41	3
Commodity position risk requirement	-	-	5	-
Specific interest rate risk of securitisation positions	142	11	22	2
Total Market Risk	11,082	887	11,394	912
OPERATIONAL RISK				
Standardised Approach	26,594	2,128	27,939	2,235
Total Operational Risk	26,594	2,128	27,939	2,235
TOTAL	263,850	21,108	310,299	24,824

RISK WEIGHTED ASSET MOVEMENT BY KEY DRIVER

Table 18: **RWA movement by key driver**

	£bn	£bn
At 1 January 2013		**310.3**
Management of the balance sheet	**(1.8)**	
Disposals	**(20.7)**	
External economic factors	**(15.4)**	
Model and methodology changes	**3.2**	
Regulatory policy changes	**(5.4)**	
Other	**0.4**	
Credit risk RWA movement		**(39.7)**
Counterparty credit risk RWA movement		**(5.1)**
Market risk RWA movement		**(0.3)**
Operational risk RWA movement		**(1.3)**
At 31 December 2013		**263.9**

The RWA movements table provides an analysis of the movement in RWAs in 2013 and an insight in to the key drivers of the movements in credit risk RWAs over the course of the year as follows:

- Management of the balance sheet includes RWA movements arising from new lending and asset run off. During 2013 there was a small RWA reduction of £1.8bn in this category.

- Disposals include RWA reductions arising from the sale of assets, portfolios and businesses. Disposals reduced RWAs by £20.7bn, primarily reflecting non-core disposals in Commercial Banking and Wealth, Asset Finance and International.

- External economic factors captures movements driven by changes in the economic environment. The reduction in RWAs of £15.4bn is mainly due to changes in underlying credit quality, favourable house price movements, and non-core exposures moving into default under the Foundation IRB approach.

- Model and methodology changes include the movement in RWAs arising from new model implementation, model enhancement and changes in credit risk approach applied to certain portfolios. Model and methodology changes increased RWAs by £3.2bn.

- Regulatory policy changes represent changes required by regulatory authorities. Substantially all of the £5.4bn reduction is due to the implementation of slotting models relating to Commercial Real Estate and other exposures in the UK and Ireland.

Within the categories above, RWA movements can arise as a result of credit risk exposures becoming adjustments to capital resources, through expected losses, rather than being risk weighted.

DIVISIONAL RISK WEIGHTED ASSETS

The risk weighted assets of the Divisions as at 31 December 2013 are presented in the table below.

Table 19: **Divisional risk weighted assets**

(All figures are in £m)	2013 Retail	2013 Commercial Banking	2013 WAFI	2013 Group Ops & Central Items	2013 TOTAL
CREDIT RISK					
Exposures subject to the IRB Approach					
Foundation IRB Approach					
Corporate - Main	-	47,106	1,665	-	48,771
Corporate - SME	-	10,570	-	-	10,570
Corporate - Specialised lending	-	100	-	-	100
Central governments and central banks	-	428	-	1,151	1,579
Institutions	-	1,337	1	1	1,339
Retail IRB Approach					
Retail - Residential mortgages	38,308	4,492	9,713	-	52,513
Retail - Qualifying revolving retail exposures	16,355	-	-	-	16,355
Retail - Other retail	11,968	-	1,703	-	13,671
Retail - SME	-	2,600	-	-	2,600
Other IRB Approaches [1]					
Corporate - Specialised lending	-	19,523	988	-	20,511
Equities - Exchange traded	-	11	-	296	307
Equities - Private equity	-	5,140	-	-	5,140
Equities - Other	-	105	75	275	455
Securitisation positions [2]	-	3,312	-	7	3,319
Total - IRB Approach	66,631	94,724	14,145	1,730	177,230
Exposures subject to the Standardised Approach					
Central governments and central banks	-	40	9	-	49
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	9	-	-	9
Multilateral development banks	-	-	-	-	-
Institutions	91	71	24	109	295
Corporates	4	12,834	2,898	1,238	16,974
Retail	1,352	1,144	1,527	-	4,023
Secured by mortgages on residential property	1,444	-	1,091	-	2,535
Secured by mortgages on commercial real estate	-	136	70	-	206
Past due items	717	960	1,065	-	2,742
Items belonging to regulatory high risk categories	-	1	-	-	1
Short term claims on institutions or corporates	-	830	-	-	830
Collective investment undertakings	31	-	18	-	49
Other items [3]	630	733	1,592	10,482	13,437
Total - Standardised Approach	4,269	16,758	8,294	11,829	41,150
Total Credit Risk	70,900	111,482	22,439	13,559	218,380
COUNTERPARTY CREDIT RISK					
IRB Approach	-	6,937	-	145	7,082
Standardised Approach	-	706	6	-	712
Total Counterparty Credit Risk	-	7,643	6	145	7,794
MARKET RISK					
Internal Models Approach	-	9,031	-	-	9,031
Standardised Approach					
Interest rate position risk requirement	-	1,557	-	-	1,557
Foreign currency position risk requirement	-	299	-	42	341
Equity position risk requirement	-	11	-	-	11
Commodity position risk requirement	-	-	-	-	-
Specific interest rate risk of securitisation positions	-	142	-	-	142
Total Market Risk	-	11,040	-	42	11,082
OPERATIONAL RISK					
Standardised Approach	14,777	8,376	3,441	-	26,594
Total Operational Risk	14,777	8,376	3,441	-	26,594
TOTAL	85,677	138,541	25,886	13,746	263,850

Notes

[1] Credit risk exposures subject to other IRB approaches include 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 and the Ratings Based Approach.

[2] Securitisation positions exclude amounts allocated to the 1,250% risk weight category. These amounts are deducted from capital, after the application of value adjustments, rather than being risk weighted at 1,250%.

[3] Other items (Standardised Approach) predominantly relate to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, cash, items in the course of collection, prepayments, sundry debtors and deferred tax assets.

(All figures are in £m)	2012 Retail	2012 Commercial Banking	2012 WAFI	2012 Group Ops & Central Items	2012 TOTAL
CREDIT RISK					
Exposures subject to the IRB Approach					
Foundation IRB Approach					
Corporate - Main	-	53,388	1,447	-	54,835
Corporate - SME	-	12,628	-	-	12,628
Corporate - Specialised lending	-	5,368	-	-	5,368
Central governments and central banks	-	192	-	1,245	1,437
Institutions	-	1,438	8	1	1,447
Retail IRB Approach					
Retail - Residential mortgages	45,695	2,629	8,197	6	56,527
Retail - Qualifying revolving retail exposures	17,261	-	-	-	17,261
Retail - Other retail	13,067	-	2,139	-	15,206
Retail - SME	-	2,451	-	-	2,451
Other IRB Approaches [1]					
Corporate - Specialised lending	-	4,897	-	-	4,897
Equities - Exchange traded	-	248	-	-	248
Equities - Private equity	-	4,917	-	-	4,917
Equities - Other	-	238	100	206	544
Securitisation positions [2]	-	6,680	-	7	6,687
Total - IRB Approach	76,023	95,074	11,891	1,465	184,453
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	105	-	105
Regional governments or local authorities	-	1	17	-	18
Administrative bodies and non-commercial undertakings	-	55	7	-	62
Multilateral development banks	-	-	-	-	-
Institutions	65	174	207	120	566
Corporates	12	18,281	5,318	1,926	25,537
Retail	1,152	1,098	3,354	-	5,604
Secured by mortgages on residential property	1,905	-	5,045	-	6,950
Secured by mortgages on commercial real estate	-	13,938	1,262	-	15,200
Past due items	828	2,035	3,355	-	6,218
Items belonging to regulatory high risk categories	-	1	-	-	1
Short term claims on institutions or corporates	-	187	-	-	187
Collective investment undertakings	38	-	15	-	53
Other items [3]	684	985	1,600	9,895	13,164
Total - Standardised Approach	4,684	36,755	20,285	11,941	73,665
Total Credit Risk	80,707	131,829	32,176	13,406	258,118
COUNTERPARTY CREDIT RISK					
IRB Approach	-	6,115	-	47	6,162
Standardised Approach	-	6,686	-	-	6,686
Total Counterparty Credit Risk	-	12,801	-	47	12,848
MARKET RISK					
Internal Models Approach	-	9,316	-	-	9,316
Standardised Approach					
Interest rate position risk requirement	-	1,711	8	-	1,719
Foreign currency position risk requirement	-	291	-	-	291
Equity position risk requirement	-	41	-	-	41
Commodity position risk requirement	-	5	-	-	5
Specific interest rate risk of securitisation positions	-	22	-	-	22
Total Market Risk	-	11,386	8	-	11,394
OPERATIONAL RISK					
Standardised Approach	14,763	9,193	3,983	-	27,939
Total Operational Risk	14,763	9,193	3,983	-	27,939
TOTAL	95,470	165,209	36,167	13,453	310,299

Notes

[1] Credit risk exposures subject to other IRB approaches include 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 and the Ratings Based Approach.

[2] Securitisation positions exclude amounts allocated to the 1,250% risk weight category. These amounts are deducted from capital, after the application of value adjustments, rather than being risk weighted at 1,250%.

[3] Other items (Standardised Approach) predominantly relate to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, cash, items in the course of collection, prepayments, sundry debtors and deferred tax assets.

LLOYDS BANKING GROUP PILLAR 2 CAPITAL REQUIREMENT

Pillar 1 of the Basel framework sets a minimum total amount of capital equal to 8 per cent of risk weighted assets. Of this amount 4 per cent must be covered by common equity tier 1 capital from 1 January 2014, rising to 4.5 per cent from 1 January 2015.

In order to address the requirements of Pillar 2 of the Basel framework, the PRA currently sets additional minimum requirements through the issuance of bank specific Individual Capital Guidance ('ICG'). A key input into the PRA's ICG setting process is a bank's own assessment of the amount of capital it needs, a process known as the Internal Capital Adequacy Assessment Process ('ICAAP'). The Group has been given an ICG by the PRA and maintains capital at a level which exceeds this requirement. From 1 January 2015 at least 56 per cent of ICG must be covered by common equity tier 1 capital and 75 per cent by tier 1 capital. The PRA has made it clear that each ICG remains a confidential matter between a bank and the PRA.

The LBG ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk, operational risk and market risk (trading book) by assessments of the material risks not covered or not fully 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. This includes a detailed internal review of the models, their embedding in business use and an external review of these models by the PRA.

Some of the key risks assessed within the ICAAP include:

Risks not fully captured under Pillar 1

- Concentration Risk – greater loss volatility arising from a higher level of loan default correlation than is assumed by the Pillar 1 assessment. Such correlation can arise from, for example, geographic, industry sector and single name concentrations.

- Underestimation Risk – where it is considered that the Pillar 1 capital assessments for credit, market or operational risk underestimate the risk. This assessment includes consideration of conduct risk but, for credit risk, excludes the risk arising as a result of loan default correlation which is covered by the concentration risk assessment.

Risks not covered by Pillar 1

- Pension Obligation Risk - the potential for additional unplanned costs that the Group would incur in the event of a significant deterioration in the funding position of the Group's defined benefit pension schemes.

- Interest Rate Risk in the Banking Book - the potential losses in the non-trading book resulting from interest rate changes or widening of the spread between Bank Base Rate and LIBOR rates.

As part of the capital planning process, forecast capital positions are subjected to extensive stress analyses to determine the adequacy of the Group's capital resources against the minimum requirements including ICG in the defined stress scenarios. The PRA uses the output from some of these stress analyses to set a Capital Planning Buffer for the Group defining the minimum level of capital buffers, over and above the minimum regulatory requirements, that should be maintained now as mitigation against potential future periods of stress.

The detailed ICAAP document is subject to a robust review process, approved by the Board and submitted to the PRA.

CREDIT RISK

DEFINITION

Credit risk is defined as the risk that parties with whom the Group has contracted fail to meet their obligations (both on and off-balance sheet).

RISK APPETITE

Credit risk appetite is set at Board level and is described and reported through a suite of metrics derived from a combination of accounting and credit portfolio performance measures, which may include the use of various credit risk rating systems as inputs. These metrics are supported by more detailed appetite metrics at divisional and business level and 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 Risk Committee, the Group Chief Executive allocates this risk appetite across the Group.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances, contingent liabilities, commitments, debt securities and derivatives to customers, financial institutions and sovereigns. The credit risk exposures are categorised as ‘retail’, arising primarily in the Retail and Wealth, Asset Finance and International divisions, ‘commercial’ and ‘corporate’, ‘financial institutions’ or ‘sovereigns’ arising in the Commercial Banking and Wealth, Asset Finance and International divisions.

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 also 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 without notice and the creditworthiness of customers is monitored frequently. Most commercial term commitments to extend credit are contingent upon customers maintaining specific credit standards, which are monitored regularly.

Loans and advances, contingent liabilities, commitments, debt securities and derivatives also expose the Group to refinance risk. Refinance risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. If the Group does not wish to refinance the exposure then there is refinance risk if the obligor is unable to repay by securing alternative finance. This may be because the borrower is in financial difficulty, or because the terms required to refinance are outside acceptable market appetite at the time. Refinance risk exposures are managed in accordance with the Group’s existing credit risk policies, processes and controls, and are not considered to be material given the Group’s prudent and through the cycle credit risk appetite. Where refinance risk exists (such as in the interest only retail mortgage portfolio and the Commercial Banking non-core book) exposures are minimised through intensive account management and are impaired where appropriate.

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

Under the regulatory 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 - General

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.

Corporate Exposures – Specialised Lending

The PRA 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 PRA. 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 those possessing all the following characteristics, either in legal form or economic substance:

- the exposure is typically to an entity, often a structured entity ('SE'), which was created specifically to finance and / or operate physical assets;
- aside from the asset(s) being financed 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 development portfolios (IPRE), major asset financing transactions such as shipping and aircraft (object finance) and energy and infrastructure financing transactions (project finance).

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 regulatory threshold for recognition as corporate SME exposures and which are generally managed as retail exposures through Commercial Banking 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 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’).

For regulatory capital purposes the Group’s rating systems assess probability of default and if appropriate, exposure at default and loss given default, in order to derive an expected loss. If not appropriate, regulatory prescribed exposure at default and loss given default values are used in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for loss events that have occurred 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.

The quality definition of both retail and commercial counterparties / exposures is largely based on the outcomes of credit risk (probability of default – PD) models. The Group operates a significant number of different rating models, typically developed internally using statistical analysis and management judgement – retail models rely more on the former, commercial models include more of the latter, especially in the larger corporate and more specialised lending portfolios. Internal data is supplemented with external data in model development, where appropriate.

The models vary, inter alia, in the extent to which they are point in time versus through the cycle. The models are subject to rigorous validation and oversight / governance including, where appropriate, benchmarking to external information.

In commercial portfolios the PD models segment counterparties into a number of rating grades, with each grade representing a defined range of default probabilities, and there are a number of different model rating scales. Counterparties/exposures migrate between rating grades if the assessment of the PD changes. The modelled PDs ‘map’ through local scales to a single Corporate (non-retail) Master Scale comprising of 19 non-default ratings. Together with four default ratings the Corporate Master Scale forms the basis on which internal reporting is completed.

In its principal retail 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.

For reporting purposes, counterparties are also segmented into a number of rating grades, each representing a defined range of default probabilities and exposures migrate between rating grades if the assessment of the counterparty probability of default changes.

Each rating model is subject to a validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. The most material rating models are approved by the Group Risk Committee. Responsibility for the approval of the remaining material rating models, and the governance framework in place around all Group models, is delegated to the Group Model Governance Committee.

MONITORING

In conjunction with Risk Division, businesses 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. Risk Division in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the GRC and the BRC.

The performance of all rating models is monitored on a regular basis, in order to seek to ensure that models provide appropriate risk differentiation capability, the generated ratings remain as accurate and robust as practical, 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 the monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated in accordance with the governance framework set by the Group Model Governance Committee.

CREDIT RISK EXPOSURE: ANALYSIS BY EXPOSURE CLASS

As at 31 December 2013 the total credit risk exposures of the Group amounted to £724.9bn (2012: £759.0bn).

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.

Table 20: **Credit risk exposures**

Exposure Class	2013 Credit Risk Exposure £m	2013 Risk Weighted Assets £m	2013 Average Risk Weight %	2013 Average Credit Risk Exposure [4] £m
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate - Main	88,805	48,771	55%	92,768
Corporate - SME	14,450	10,570	73%	17,943
Corporate - Specialised lending	165	100	60%	3,753
Central governments and central banks	15,063	1,579	10%	20,367
Institutions	5,318	1,339	25%	5,789
Retail IRB Approach				
Retail - Residential mortgages	364,089	52,513	14%	357,822
Retail - Qualifying revolving retail exposures	38,352	16,355	43%	37,564
Retail - Other retail	13,391	13,671	102%	13,869
Retail - SME	2,864	2,600	91%	3,031
Other IRB Approaches [1]				
Corporate - Specialised lending	33,177	20,511	62%	27,514
Equities - Exchange traded	106	307	290%	81
Equities - Private equity	2,705	5,140	190%	2,730
Equities - Other	123	455	370%	142
Securitisation positions [2]	13,860	3,319	24%	16,233
Total - IRB Approach	592,468	177,230	30%	599,606
Exposures subject to the Standardised Approach				
Central governments and central banks	78,523	49	0%	85,750
Regional governments or local authorities	-	-	-	39
Administrative bodies and non-commercial undertakings	9	9	100%	99
Multilateral development banks	-	-	-	51
Institutions	948	295	31%	1,768
Corporates	18,354	16,974	92%	25,335
Retail	5,325	4,023	76%	7,888
Secured by mortgages on residential property	7,098	2,535	36%	13,721
Secured by mortgages on commercial real estate	191	206	108%	4,230
Past due items	2,300	2,742	119%	3,517
Items belonging to regulatory high risk categories	1	1	150%	1
Short term claims on institutions or corporates	826	830	101%	341
Collective investment undertakings	241	49	20%	255
Other items [3]	18,657	13,437	72%	18,665
Total - Standardised Approach	132,473	41,150	31%	161,660
TOTAL	724,941	218,380	30%	761,266

Notes

[1] Credit risk exposures subject to other IRB approaches include 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 and the Ratings Based Approach.

[2] Securitisation positions exclude amounts allocated to the 1,250% risk weight category. These amounts are deducted from capital, after the application of value adjustments, rather than being risk weighted at 1,250%.

[3] Other items (Standardised Approach) predominantly relate to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, cash, items in the course of collection, prepayments, sundry debtors and deferred tax assets.

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

Key Movements

- **Foundation IRB Corporate Main** exposures reduced by £6.1bn during the year to £88.8bn, primarily driven by non-core disposals and general asset run off, partially offset by increased core lending. Risk weighted assets reduced by £6.1bn to £48.8bn mainly due to the reduction in exposures and improvements in credit quality, partially offset by increases resulting from model updates. The resultant reduction in the average risk weight (from 58% to 55%) is reflective of the overall improvement in the risk mix of the portfolio, further analysis of which is provided on page 58.

- **Foundation IRB Corporate SME** exposures reduced by £4.6bn during the year to £14.5bn and risk weighted assets by £2.1bn to £10.6bn. This was driven by a reclassification of exposures to other exposure classes and included a significant proportion of the defaulted exposures in the portfolio. The overall increase in the average risk weight from 66% to 73% primarily reflects the reduction in defaulted exposures following the reclassifications - defaulted exposures do not receive a risk weight under the Foundation IRB Approach, being subject instead to a higher EL charge.

- **Foundation IRB Corporate specialised lending** exposures reduced from £7.1bn to £0.2bn during the year with risk weighted assets reducing from £5.4bn to £0.1bn, primarily reflecting the transition of portfolios to the IRB Supervisory Slotting Approach.

Notes in relation to the references below can be found on page 37.

Exposure Class	2012 Credit Risk Exposure £m	2012 Risk Weighted Assets £m	2012 Average Risk Weight %	2012 Average Credit Risk Exposure [4] £m
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate - Main	94,908	54,835	58%	97,303
Corporate - SME	19,053	12,628	66%	21,239
Corporate - Specialised lending	7,110	5,368	76%	7,721
Central governments and central banks	10,238	1,437	14%	11,519
Institutions	5,690	1,447	25%	8,348
Retail IRB Approach				
Retail - Residential mortgages	355,966	56,527	16%	357,875
Retail - Qualifying revolving retail exposures	36,305	17,261	48%	37,383
Retail - Other retail	14,306	15,206	106%	15,434
Retail - SME	2,810	2,451	87%	2,805
Other IRB Approaches [1]				
Corporate - Specialised lending	6,856	4,897	71%	6,541
Equities - Exchange traded	86	248	290%	75
Equities - Private equity	2,591	4,917	190%	2,515
Equities - Other	147	544	370%	227
Securitisation positions [2]	19,847	6,687	34%	23,760
Total - IRB Approach	575,913	184,453	32%	592,745
Exposures subject to the Standardised Approach				
Central governments and central banks	93,094	105	0%	94,131
Regional governments or local authorities	42	18	43%	43
Administrative bodies and non-commercial undertakings	76	62	82%	290
Multilateral development banks	83	-	-	83
Institutions	1,201	566	47%	1,172
Corporates	27,290	25,537	94%	31,364
Retail	7,479	5,604	75%	7,719
Secured by mortgages on residential property	15,891	6,950	44%	16,661
Secured by mortgages on commercial real estate	13,821	15,200	110%	17,598
Past due items	5,506	6,218	113%	6,967
Items belonging to regulatory high risk categories	1	1	150%	505
Short term claims on institutions or corporates	179	187	105%	247
Collective investment undertakings	261	53	20%	237
Other items [3]	18,195	13,164	72%	20,287
Total - Standardised Approach	183,119	73,665	40%	197,304
TOTAL	759,032	258,118	34%	790,049

Key Movements – cont.

- **Foundation IRB central governments and central banks** exposures increased by £4.8bn to £15.1bn as a result of an increase in exposure to the US Federal Reserve Bank of New York. The average risk weight reduced from 14% to 10% as a result of holding a higher proportion of short term deposits over longer term treasury bills at year end.

- **Retail IRB residential mortgage** exposures increased by £8.1bn to £364.1bn mainly due to the roll out of the BOS Netherlands IRB residential mortgage model, with a corresponding reduction in standardised residential mortgage exposures. Risk weighted assets reduced by £4.0bn to £52.5bn primarily due to improvements in credit quality reflecting effective portfolio management and the impact of positive macroeconomic factors, including favourable movements in UK house prices, partially offset by additional risk weighted assets arising from the BOS Netherlands model roll out.

- The average risk weights for **Retail IRB qualifying revolving retail exposures and other retail exposures** reduced from 48% to 43% and 106% to 102% respectively as a result of an improved risk mix within the portfolios.

- **Corporate specialised lending exposures subject to the IRB Supervisory Slotting Approach** increased from £6.9bn to £33.2bn, with risk weighted assets increasing from £4.9bn to £20.5bn and the resultant average risk weight reducing from 71% to 62%. The primary driver of this increase is the transitioning of Standardised Approach and Foundation IRB Approach commercial real estate portfolios to the supervisory slotting approach in line with PRA requirements. The average risk weight reduction is due to a greater proportion of defaulted deals moving onto this approach that carry no risk weight, but generate an increased expected loss.

- **Securitisation positions** have reduced by £6.0bn to £13.9bn primarily due to the disposal of the Group's holding in a portfolio of re-securitised US Residential Mortgage Backed Securities, the closure of a commercial loans synthetic securitisation programme and further disposal of holdings in third party asset backed securities.

- **Standardised Approach central governments and central bank exposures** reduced by £ 14.6bn to £78.5bn, reflecting a reduction in deposits with the Dutch Central Bank and the repayment of funding provided through the Long Term Refinancing Operation from the European Central Bank, offset by an increase in holdings of UK Government Gilts.

- **Standardised Approach corporates, exposures secured by mortgages on commercial real estate and past due items** reduced by £25.8bn during the year, primarily reflecting the transitioning of portfolios to the IRB Supervisory Slotting Approach and non-core asset disposals through Commercial Banking and WAFI.

- **Standardised Approach retail exposures and exposures secured by mortgages on residential property** reduced by £10.9bn during the year, primarily reflecting the roll out of BOS Netherlands IRB residential mortgage model and non-core disposals through the sale of the Group's Australian and Spanish businesses.

CREDIT RISK EXPOSURE: ANALYSIS BY DIVISION

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

Table 21: **Divisional credit risk exposures**

Division	Risk Weight Approach	2013 Credit Risk Exposure £m	2012 Credit Risk Exposure £m
Retail	IRB	390,162	387,154
	Standardised	9,904	10,069
Commercial Banking	IRB	172,848	169,393
	Standardised	56,300	109,605
WAFI	IRB	22,224	11,932
	Standardised	13,113	31,799
Group Ops & Central Items	IRB	7,234	7,434
	Standardised	53,156	31,646
Total		724,941	759,032

CREDIT RISK EXPOSURE: ANALYSIS BY INDUSTRY

Credit risk exposures as at 31 December 2013, analysed by major industrial sector, are provided in the table below.

Table 22: **Credit risk exposure analysed by major industrial sector**

(All figures are in £m)	2013 Agriculture, Forestry and Fishing	2013 Energy and Water Supply	2013 Manufacturing	2013 Construction	2013 Transport, Distribution and Hotels	2013 Postal and Comms	2013 Property Companies	2013 Financial, Business and Other Services	2013 Personal: Mortgages	2013 Personal: Other	2013 Lease Financing	2013 Hire Purchase	2013 TOTAL
Exposures subject to the IRB Approach													
Foundation IRB Approach													
Corporate - Main	160	3,388	11,555	3,358	11,776	4,156	14,743	35,244	-	-	2,874	1,551	88,805
Corporate - SME	1,043	46	1,525	487	2,890	38	3,522	4,622	-	3	1	273	14,450
Corporate - Specialised lending	-	-	-	-	10	-	120	35	-	-	-	-	165
Central governments and central banks	-	-	-	-	-	-	-	15,063	-	-	-	-	15,063
Institutions	-	30	-	-	76	-	-	5,106	-	-	105	1	5,318
Retail IRB Approach													
Retail - Residential mortgages	1,457	6	341	374	1,956	40	4,369	2,703	352,841	2	-	-	364,089
Retail - Qualifying revolving retail exposures	-	-	-	-	-	-	-	-	-	38,352	-	-	38,352
Retail - Other retail	-	-	-	-	-	-	-	-	-	10,016	-	3,375	13,391
Retail - SME	327	3	240	387	848	24	607	423	-	5	-	-	2,864
Other IRB Approaches													
Corporate - Specialised lending	15	980	307	1,136	2,614	17	22,165	5,194	-	-	749	-	33,177
Equities - Exchange traded	-	-	-	-	-	-	1	105	-	-	-	-	106
Equities - Private equity	-	127	392	238	57	397	510	984	-	-	-	-	2,705
Equities - Other	-	-	-	-	-	-	6	117	-	-	-	-	123
Securitisation positions	1	-	6	1	25	-	28	13,799	-	-	-	-	13,860
Total – IRB Approach	3,003	4,580	14,366	5,981	20,252	4,672	46,071	83,395	352,841	48,378	3,729	5,200	592,468
Exposures subject to the Standardised Approach													
Central governments and central banks	-	-	-	-	-	-	-	78,452	-	-	69	2	78,523
Regional governments or local authorities	-	-	-	-	-	-	-	-	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	-	-	-	-	-	-	9	-	-	-	-	9
Multilateral development banks	-	-	-	-	-	-	-	-	-	-	-	-	-
Institutions	-	-	-	-	-	-	-	948	-	-	-	-	948
Corporates	2,173	518	1,394	386	3,988	126	2,046	6,290	23	1,196	202	12	18,354
Retail	1,472	2	-	-	2	3	2	51	1,054	2,596	30	113	5,325
Secured by mortgages on residential property	-	-	-	-	-	-	-	-	7,098	-	-	-	7,098
Secured by mortgages on commercial real estate	1	-	2	3	9	-	145	31	-	-	-	-	191
Past due items	13	7	99	31	578	-	245	437	746	142	-	2	2,300
Items belonging to regulatory high risk categories	-	-	-	-	-	-	1	-	-	-	-	-	1
Short term claims on institutions or corporates	-	-	21	-	13	-	11	780	-	1	-	-	826
Collective investment undertakings	-	-	-	-	-	-	-	241	-	-	-	-	241
Total – Standardised Approach	3,659	527	1,516	420	4,590	129	2,450	87,239	8,921	3,935	301	129	113,816
Total	6,662	5,107	15,882	6,401	24,842	4,801	48,521	170,634	361,762	52,313	4,030	5,329	706,284
Other items													18,657
Total Credit Risk Exposure													724,941

(All figures are in £m)	2012 Agriculture, Forestry and Fishing	2012 Energy and Water Supply	2012 Manufacturing	2012 Construction	2012 Transport, Distribution and Hotels	2012 Postal and Comms	2012 Property Companies	2012 Financial, Business and Other Services	2012 Personal: Mortgages	2012 Personal: Other	2012 Lease Financing	2012 Hire Purchase	2012 TOTAL
Exposures subject to the IRB Approach													
Foundation IRB Approach													
Corporate - Main	300	2,413	11,941	4,451	12,387	2,752	16,152	40,118	-	9	3,180	1,205	94,908
Corporate - SME	753	30	1,428	627	2,572	325	7,469	5,373	-	17	71	388	19,053
Corporate - Specialised lending	8	-	-	64	48	-	6,350	640	-	-	-	-	7,110
Central governments and central banks	-	-	-	-	-	-	-	10,238	-	-	-	-	10,238
Institutions	-	45	-	-	-	-	-	5,317	-	-	328	-	5,690
Retail IRB Approach													
Retail - Residential mortgages	1,327	4	323	378	1,688	30	4,108	1,686	346,420	2	-	-	355,966
Retail - Qualifying revolving retail exposures	-	-	-	-	-	-	-	-	-	36,305	-	-	36,305
Retail - Other retail	-	-	-	-	-	-	-	-	-	11,211	-	3,095	14,306
Retail - SME	227	2	248	412	757	22	326	811	-	5	-	-	2,810
Other IRB Approaches													
Corporate - Specialised lending	-	951	27	325	2,099	8	637	1,988	-	-	821	-	6,856
Equities - Exchange traded	-	-	-	-	-	-	13	73	-	-	-	-	86
Equities - Private equity	-	-	-	-	29	-	561	2,001	-	-	-	-	2,591
Equities - Other	-	-	-	-	-	-	7	140	-	-	-	-	147
Securitisation positions	172	-	70	52	552	12	287	18,702	-	-	-	-	19,847
Total – IRB Approach	2,787	3,445	14,037	6,309	20,132	3,149	35,910	87,087	346,420	47,549	4,400	4,688	575,913
Exposures subject to the Standardised Approach													
Central governments and central banks	-	-	-	-	-	-	-	93,068	-	-	26	-	93,094
Regional governments or local authorities	-	-	-	-	-	-	-	12	-	-	30	-	42
Administrative bodies and non-commercial undertakings	-	2	-	-	-	-	-	57	-	-	17	-	76
Multilateral development banks	-	-	-	-	-	-	-	83	-	-	-	-	83
Institutions	-	-	-	-	-	-	-	1,201	-	-	-	-	1,201
Corporates	1,953	1,350	1,146	690	3,594	1,143	3,008	10,072	15	1,494	2,730	95	27,290
Retail	1,462	14	60	101	44	72	18	496	24	4,464	315	409	7,479
Secured by mortgages on residential property	1	-	3	3	8	1	68	12	15,795	-	-	-	15,891
Secured by mortgages on commercial real estate	2	-	13	107	320	9	11,799	1,522	-	45	4	-	13,821
Past due items	22	19	102	118	871	415	2,149	450	1,157	197	-	6	5,506
Items belonging to regulatory high risk categories	-	-	-	-	-	-	-	1	-	-	-	-	1
Short term claims on institutions or corporates	7	-	14	-	6	2	-	149	-	1	-	-	179
Collective investment undertakings	-	-	-	-	-	-	-	261	-	-	-	-	261
Total – Standardised Approach	3,447	1,385	1,338	1,019	4,843	1,642	17,042	107,384	16,991	6,201	3,122	510	164,924
Total	6,234	4,830	15,375	7,328	24,975	4,791	52,952	194,471	363,411	53,750	7,522	5,198	740,837
Other items													18,195
Total Credit Risk Exposure													759,032

CREDIT RISK EXPOSURE: ANALYSIS BY GEOGRAPHY

Credit risk exposures as at 31 December 2013, analysed by geographical region, based on the country of residence of the customer, are provided in the table below.

Table 23: **Credit risk exposures analysed by geographical region**

(All figures are in £m)	2013 United Kingdom	2013 Rest of Europe	2013 United States of America	2013 Asia-Pacific	2013 Other	2013 TOTAL
Exposures subject to the IRB Approach						
Foundation IRB Approach						
Corporate - Main	68,818	9,547	8,157	747	1,536	88,805
Corporate - SME	14,287	163	-	-	-	14,450
Corporate - Specialised lending	149	8	-	-	8	165
Central governments and central banks	15	23	14,667	-	358	15,063
Institutions	1,843	2,005	617	519	334	5,318
Retail IRB Approach						
Retail - Residential mortgages	353,653	10,436	-	-	-	364,089
Retail - Qualifying revolving retail exposures	38,352	-	-	-	-	38,352
Retail - Other retail	13,316	75	-	-	-	13,391
Retail - SME	2,864	-	-	-	-	2,864
Other IRB Approaches						
Corporate - Specialised lending	21,558	9,356	466	575	1,222	33,177
Equities - Exchange traded	4	102	-	-	-	106
Equities - Private equity	2,343	266	65	5	26	2,705
Equities - Other	87	8	-	28	-	123
Securitisation positions [1]	10,293	1,896	1,503	-	168	13,860
Total – IRB Approach	527,582	33,885	25,475	1,874	3,652	592,468
Exposures subject to the Standardised Approach						
Central governments and central banks	67,963	10,533	-	18	9	78,523
Regional governments or local authorities	-	-	-	-	-	-
Administrative bodies and non-commercial undertakings	9	-	-	-	-	9
Multilateral development banks	-	-	-	-	-	-
Institutions	805	62	53	26	2	948
Corporates	11,518	4,081	1,425	708	622	18,354
Retail	4,283	1,022	4	14	2	5,325
Secured by mortgages on residential property	5,691	340	115	735	217	7,098
Secured by mortgages on commercial real estate	106	84	-	-	1	191
Past due items	927	1,058	66	197	52	2,300
Items belonging to regulatory high risk categories	1	-	-	-	-	1
Short term claims on institutions or corporates	28	35	9	-	754	826
Collective investment undertakings	241	-	-	-	-	241
Total – Standardised Approach	91,572	17,215	1,672	1,698	1,659	113,816
Total	619,154	51,100	27,147	3,572	5,311	706,284
Other items						18,657
Total Credit Risk Exposure						724,941

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

(All figures are in £m)	2012 United Kingdom	2012 Rest of Europe	2012 United States of America	2012 Asia-Pacific	2012 Other	2012 TOTAL
Exposures subject to the IRB Approach						
Foundation IRB Approach						
Corporate - Main	68,746	12,202	10,797	915	2,248	94,908
Corporate - SME	18,827	88	54	33	51	19,053
Corporate - Specialised lending	5,585	1,076	88	5	356	7,110
Central governments and central banks	-	287	9,727	6	218	10,238
Institutions	1,664	2,939	536	339	212	5,690
Retail IRB Approach						
Retail - Residential mortgages	350,368	5,598	-	-	-	355,966
Retail - Qualifying revolving retail exposures	36,305	-	-	-	-	36,305
Retail - Other retail	14,236	70	-	-	-	14,306
Retail - SME	2,810	-	-	-	-	2,810
Other IRB Approaches						
Corporate - Specialised lending	3,369	1,571	947	90	879	6,856
Equities - Exchange traded	86	-	-	-	-	86
Equities - Private equity	2,349	148	75	-	19	2,591
Equities – Other	78	15	-	54	-	147
Securitisation positions [1]	16,319	2,453	973	-	102	19,847
Total – IRB Approach	520,742	26,447	23,197	1,442	4,085	575,913
Exposures subject to the Standardised Approach						
Central governments and central banks	56,115	36,830	-	44	105	93,094
Regional governments or local authorities	12	-	-	30	-	42
Administrative bodies and non-commercial undertakings	56	-	-	17	3	76
Multilateral development banks	-	83	-	-	-	83
Institutions	867	114	56	29	135	1,201
Corporates	15,078	5,783	1,014	4,185	1,230	27,290
Retail	4,176	216	8	3,031	48	7,479
Secured by mortgages on residential property	5,425	8,736	306	1,237	187	15,891
Secured by mortgages on commercial real estate	10,251	3,253	44	14	259	13,821
Past due items	1,738	3,221	104	370	73	5,506
Items belonging to regulatory high risk categories	1	-	-	-	-	1
Short term claims on institutions or corporates	142	26	9	-	2	179
Collective investment undertakings	261	-	-	-	-	261
Total – Standardised Approach	94,122	58,262	1,541	8,957	2,042	164,924
Total	614,864	84,709	24,738	10,399	6,127	740,837
Other items						18,195
Total Credit Risk Exposure						759,032

[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 2013, analysed by residual contractual maturity, are provided in the table below.

Table 24: **Credit risk exposures analysed by residual contractual maturity**

(All figures are in £m)	2013 On demand	2013 Repayable in 3 months or less	2013 Repayable between 3 months and 1 year	2013 Repayable between 1 and 5 years	2013 Repayable over 5 years or undated	2013 TOTAL
Exposures subject to the IRB Approach						
Foundation IRB Approach						
Corporate - Main	3,207	4,588	18,748	46,291	15,971	88,805
Corporate - SME	946	689	4,041	3,289	5,485	14,450
Corporate - Specialised lending	25	58	14	21	47	165
Central governments and central banks	-	7,433	58	1,664	5,908	15,063
Institutions	253	832	1,379	2,029	825	5,318
Retail IRB Approach						
Retail - Residential mortgages	1,218	1,468	9,769	21,578	330,056	364,089
Retail - Qualifying revolving retail exposures	38,352	-	-	-	-	38,352
Retail - Other retail	157	82	592	10,539	2,021	13,391
Retail - SME	264	419	803	479	899	2,864
Other IRB Approaches						
Corporate - Specialised lending	523	1,697	5,555	14,527	10,875	33,177
Equities - Exchange traded	-	-	-	3	103	106
Equities - Private equity	-	-	348	1,140	1,217	2,705
Equities - Other	-	-	-	35	88	123
Securitisation positions	-	844	4,786	4,645	3,585	13,860
Total – IRB Approach	44,945	18,110	46,093	106,240	377,080	592,468
Exposures subject to the Standardised Approach						
Central governments and central banks	30,893	8,663	259	2,123	36,585	78,523
Regional governments or local authorities	-	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	-	-	-	9	9
Multilateral development banks	-	-	-	-	-	-
Institutions	487	145	-	19	297	948
Corporates	1,481	427	1,602	4,173	10,671	18,354
Retail	583	66	175	1,595	2,906	5,325
Secured by mortgages on residential property	662	26	81	466	5,863	7,098
Secured by mortgages on commercial real estate	1	6	10	115	59	191
Past due items	151	55	344	464	1,286	2,300
Items belonging to regulatory high risk categories	-	-	-	-	1	1
Short term claims on institutions or corporates	37	789	-	-	-	826
Collective investment undertakings	241	-	-	-	-	241
Total – Standardised Approach	34,536	10,177	2,471	8,955	57,677	113,816
Total	79,481	28,287	48,564	115,195	434,757	706,284
Other items						18,657
Total Credit Risk Exposure						724,941

(All figures are in £m)	2012 On demand	2012 Repayable in 3 months or less	2012 Repayable between 3 months and 1 year	2012 Repayable between 1 and 5 years	2012 Repayable over 5 years or undated	2012 TOTAL
Exposures subject to the IRB Approach						
Foundation IRB Approach						
Corporate - Main	6,395	5,476	12,768	52,682	17,587	94,908
Corporate - SME	1,666	1,138	2,277	7,765	6,207	19,053
Corporate - Specialised lending	152	987	1,027	4,402	542	7,110
Central governments and central banks	-	2,218	59	1,921	6,040	10,238
Institutions	207	893	1,027	2,697	866	5,690
Retail IRB Approach						
Retail - Residential mortgages	2,620	884	6,362	20,169	325,931	355,966
Retail - Qualifying revolving retail exposures	36,305	-	-	-	-	36,305
Retail - Other retail	203	412	1,380	9,737	2,574	14,306
Retail - SME	1,833	9	31	313	624	2,810
Other IRB Approaches						
Corporate - Specialised lending	114	219	429	2,602	3,492	6,856
Equities - Exchange traded	-	-	-	62	24	86
Equities - Private equity	1	-	-	2,029	561	2,591
Equities - Other	-	-	-	69	78	147
Securitisation positions	67	3,616	4,848	2,805	8,511	19,847
Total – IRB Approach	49,563	15,852	30,208	107,253	373,037	575,913
Exposures subject to the Standardised Approach						
Central governments and central banks	41,714	33,646	604	628	16,502	93,094
Regional governments or local authorities	-	-	1	32	9	42
Administrative bodies and non-commercial undertakings	-	-	1	23	52	76
Multilateral development banks	-	-	-	-	83	83
Institutions	553	353	72	152	71	1,201
Corporates	589	689	4,339	12,911	8,762	27,290
Retail	517	152	295	3,795	2,720	7,479
Secured by mortgages on residential property	231	67	116	700	14,777	15,891
Secured by mortgages on commercial real estate	100	1,010	2,642	7,993	2,076	13,821
Past due items	104	181	480	2,575	2,166	5,506
Items belonging to regulatory high risk categories	-	-	-	-	1	1
Short term claims on institutions or corporates	63	116	-	-	-	179
Collective investment undertakings	261	-	-	-	-	261
Total – Standardised Approach	44,132	36,214	8,550	28,809	47,219	164,924
Total	93,695	52,066	38,758	136,062	420,256	740,837
Other items						18,195
Total Credit Risk Exposure						759,032

PAST DUE EXPOSURES, IMPAIRED EXPOSURES AND IMPAIRMENT PROVISIONS

DEFINITION

For accounting purposes, past due exposures, impaired exposures and impairment provisions are defined as follows:

- **Past due 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 (also referred to as 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 provision may either be individual or collective.

ACCOUNTING POLICY

References to the Group's accounting policy in respect of impaired exposures ('financial assets') and impairment provisions raised in respect of loans and receivables are provided below.

- Impairment of financial assets, Note 2 (Accounting policies), Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report and Accounts:
  - (1) Assets accounted for at amortised cost, pages 217 to 219
  - (2) Available-for-sale financial assets, page 219

MANAGING IMPAIRED EXPOSURES AND IMPAIRMENT PROVISIONS

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 Risk Division Impairment Policies, which are reviewed and approved on an annual basis.

The policy for the treatment of impaired assets has been developed and is maintained by Risk Division who formulate and agree the policy in conjunction with Group Finance.

Adequacy Reviews

Any assessment of impairment must be based on the information and events that have already occurred as at the review or balance sheet date. Events that occur after such date may be taken into account only where they inform the position at that date.

The process for estimating impairment must consider all credit exposures and not only those in default or low credit quality.

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 are 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 and the loss allowance released.

Reporting

The Credit Risk Committees and Risk Division monitor impairment provisions on a continuous basis throughout the year. 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) is provided to the Divisional Credit Risk / Impairment Committees, Group Risk Committee, Board Risk Committee and the Audit Committee.

A consolidated risk report is produced on a monthly basis for the Group Risk Committee. This report includes comparison of actual performance against budget for the main balance sheet and income statement metrics, including asset balances, impaired assets, income statement impairment charges and balance sheet provisions.

In addition, comprehensive monthly reporting packs are produced by Risk Division, which actively manages distressed commercial assets and by Collections and Recoveries units within Retail Division.

MANAGEMENT OF CUSTOMERS EXPERIENCING FINANCIAL DISTRESS

Information and analysis on the measures adopted by the Group to support retail and commercial customers experiencing financial stress is provided in the following locations:

- Intensive care of customers in financial difficulty, Risk Management, 2013 Lloyds Banking Group plc Annual Report and Accounts:
    - Retail Customers, page 137;
    - Commercial Customers pages 137 to 138;
- Treatment of customers experiencing financial stress, Note 54 (Financial risk management), Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report and Accounts:
    - Retail customers, pages 340 to 343;
    - Asset finance retail lending, page 343;
    - Commercial customers, pages 344 to 346

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 2013, past due but not impaired exposures in respect of loans and advances to customers amounted to £13.7bn (2012: £15.3bn). Impaired exposures in respect of loans and advances to customers amounted to £32.3bn (2012: £46.3bn), of which £3.8bn (2012: £3.8bn) were classified as 'impaired – no provision required' and the remaining £28.5bn (2012: £42.5bn) 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 2013, by major industrial sector, is provided in the table below.

Table 25: **Past due but not impaired and impaired loans and advances analysed by major industrial sector**

	Past due but not impaired		Impaired	
	2013 £m	**2013 As a % of Credit Risk Exposure**	**2013 £m**	**2013 As a % of Credit Risk Exposure**
Agriculture, forestry and fishing	**58**	**0.87%**	**146**	**2.19%**
Energy and water supply	**10**	**0.20%**	**125**	**2.45%**
Manufacturing	**87**	**0.55%**	**456**	**2.87%**
Construction	**57**	**0.89%**	**1,444**	**22.56%**
Transport, distribution and hotels	**173**	**0.70%**	**5,990**	**24.11%**
Postal and communications	**19**	**0.40%**	**41**	**0.85%**
Property companies	**238**	**0.49%**	**11,112**	**22.90%**
Financial, business and other services	**134**	**0.08%**	**3,844**	**2.25%**
Personal: Mortgages	**12,329**	**3.41%**	**6,866**	**1.90%**
Personal: Other	**504**	**0.96%**	**1,989**	**3.80%**
Lease financing	**8**	**0.20%**	**41**	**1.02%**
Hire purchase	**78**	**1.46%**	**205**	**3.85%**
Total	**13,695**	**1.89%**	**32,259**	**4.45%**

	Past due but not impaired		Impaired	
	2012 £m	2012 As a % of Credit Risk Exposure	2012 £m	2012 As a % of Credit Risk Exposure
Agriculture, forestry and fishing	88	1.41%	164	2.63%
Energy and water supply	17	0.35%	46	0.95%
Manufacturing	103	0.67%	616	4.01%
Construction	96	1.31%	1,921	26.21%
Transport, distribution and hotels	384	1.54%	6,939	27.78%
Postal and communications	3	0.06%	91	1.90%
Property companies	495	0.93%	17,731	33.49%
Financial, business and other services	508	0.26%	7,580	3.90%
Personal: Mortgages	12,880	3.54%	8,132	2.24%
Personal: Other	592	1.10%	2,731	5.08%
Lease financing	54	0.72%	55	0.73%
Hire purchase	109	2.10%	287	5.52%
Total	15,329	2.02%	46,293	6.10%

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 2013, by geographical region, based on the country of residence of the customer, is provided in the table below.

Table 26: **Past due but not impaired and impaired loans and advances analysed by geographical region**

	Past due but not impaired		Impaired	
	2013 £m	2013 As a % of Credit Risk Exposure	2013 £m	2013 As a % of Credit Risk Exposure
United Kingdom	12,480	2.02%	21,418	3.46%
Rest of Europe	1,104	2.16%	10,381	20.32%
United States of America	23	0.08%	67	0.25%
Asia-Pacific	32	0.90%	272	7.61%
Other	56	1.05%	121	2.28%
Total	**13,695**	**1.89%**	**32,259**	**4.45%**

	Past due but not impaired		Impaired	
	2012 £m	2012 As a % of Credit Risk Exposure	2012 £m	2012 As a % of Credit Risk Exposure
United Kingdom	13,880	2.26%	29,625	4.82%
Rest of Europe	1,047	1.24%	14,514	17.13%
United States of America	2	0.01%	376	1.52%
Asia-Pacific	361	3.47%	648	6.23%
Other	39	0.64%	1,130	18.44%
Total	15,329	2.02%	46,293	6.10%

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 2012 to 31 December 2013, in respect of loans and advances to customers is provided below.

Table 27: **Movement in impairment provisions (loans and advances to customers)**

	£m
At 31 December 2012	15,250
Exchange and other adjustments	291
Disposal of businesses	(176)
Advances written off	(6,229)
Recoveries of advances written off in previous years	456
Unwinding of discount	(351)
Charge to the income statement	2,725
At 31 December 2013 (Lloyds Banking Group plc Annual Report and Accounts 2013, page 254)	**11,966**

	£m
At 31 December 2011	18,732
Exchange and other adjustments	(379)
Advances written off	(8,697)
Recoveries of advances written off in previous years	843
Unwinding of discount	(374)
Charge to the income statement	5,125
At 31 December 2012 (Lloyds Banking Group plc Annual Report and Accounts 2013, page 254)	15,250

Analysis by Industry

An analysis of closing impairment provisions, the net charge to the income statement and advances written off in respect of loans and advances to customers, by major industrial sector, is provided in the table below [1].

Table 28: **Impairment provisions, net charge and advances written off analysed by major industrial sector**

	2013 Impairment Provisions £m	2013 Net Charge £m	2013 Advances Written Off £m
Agriculture, forestry and fishing	38	-	11
Energy and water supply	149	95	102
Manufacturing	296	31	130
Construction	395	66	84
Transport, distribution and hotels	1,954	421	798
Postal and communications	11	(3)	14
Property companies	5,145	457	1,891
Financial, business and other services	2,293	552	1,030
Personal: Mortgages	657	224	601
Personal: Other	919	920	1,437
Lease financing	6	(26)	10
Hire purchase	103	(12)	121
Total	11,966	2,725	6,229

	2012 Impairment Provisions £m	2012 Net Charge £m	2012 Advances Written Off £m
Agriculture, forestry and fishing	67	54	45
Energy and water supply	191	71	77
Manufacturing	337	236	226
Construction	504	326	654
Transport, distribution and hotels	2,162	649	458
Postal and communications	40	8	7
Property companies	6,664	1,725	3,554
Financial, business and other services	2,764	824	1,071
Personal: Mortgages	1,113	278	133
Personal: Other	1,147	881	2,267
Lease financing	33	26	75
Hire purchase	228	47	130
Total	15,250	5,125	8,697

Notes

[1] Extracted from the 'Summary of Loan Loss Experience' analysis presented on pages 86 to 93 of the 2013 Form 20-F.

Analysis by Geography

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

Table 29: **Impairment provisions, net charges an and advances written off analysed by geographical region**

	2013 Impairment Provisions £m	2013 Net Charge £m	2013 Advances Written Off £m
United Kingdom	8,392	2,349	7,111
Rest of Europe	7,091	628	2,348
United States of America	89	2	-
Asia-Pacific	66	14	61
Other	69	(5)	-
	15,707	2,988	9,520
Fair value and other adjustments [1]	(3,741)	(263)	(3,291)
Total	11,966	2,725	6,229

	2012 Impairment Provisions £m	2012 Net Charge £m	2012 Advances Written Off £m
United Kingdom	11,545	3,976	8,038
Rest of Europe	9,227	1,382	2,416
United States of America	137	26	13
Asia-Pacific	477	301	1,494
Other	386	(31)	36
	21,772	5,654	11,997
Fair value and other adjustments [1]	(6,522)	(529)	(3,300)
Total	15,250	5,125	8,697

Notes: [1] Analysis of closing impairment provisions, the net charge to the income statement and advances written off in respect of loans and advances to customers, by geographical region, has been presented prior to the application of fair value and other adjustments. Such adjustments are not analysed on a geographical basis within the business. Further details on the fair value and other adjustments applied in respect of impairment provisions can be found on page 330 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

IMPAIRED LOANS AND ADVANCES TO BANKS

As at 31 December 2013, loans and advances to banks amounting to £nil (2012: £3m) were deemed to be impaired. Impairment provisions held in respect of these impaired balances amounted to £nil (2012: £3m). An analysis of the movement in impairment provisions, from 31 December 2012 to 31 December 2013, is provided below.

Table 30: **Movement in impairment provisions (loans and advances to banks)**

	£m
At 31 December 2012	3
Exchange and other adjustments	-
Advances written off	(3)
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	-
At 31 December 2013	-
(Lloyds Banking Group plc Annual Report and Accounts 2013, page 254)	

	£m
At 31 December 2011	14
Exchange and other adjustments	(1)
Advances written off	(10)
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	-
At 31 December 2012	3
(Lloyds Banking Group plc Annual Report and Accounts 2013, page 254)	

IMPAIRED DEBT SECURITIES CLASSIFIED AS LOANS AND RECEIVABLES

As at 31 December 2013, impairment provisions held in respect of debt securities classified as loans and receivables amounted to £125m (2012: £206m). An analysis of the movement in impairment provisions, from 31 December 2012 to 31 December 2013, is provided below.

Table 31: **Movement in impairment provisions (debt securities)**

	£m
At 31 December 2012	206
Exchange and other adjustments	-
Advances written off	(82)
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	1
At 31 December 2013	125
(Lloyds Banking Group plc Annual Report and Accounts 2012, page 254)	

	£m
At 31 December 2011	276
Exchange and other adjustments	(8)
Advances written off	(73)
Recoveries of advances written off in previous years	15
Unwinding of discount	-
Release to the income statement	(4)
At 31 December 2012	206
(Lloyds Banking Group plc Annual Report and Accounts 2012, page 254)	

FACTORS IMPACTING LOSS EXPERIENCE

The overall impairment charge reduced by 47 per cent to £3.0bn reflecting the improved credit quality of the core portfolio, continued prudent management of impaired loans and a further reduction in non-core assets.

The core impairment charge reduced by 21 per cent to £1.5bn, primarily driven by lower impairment in Commercial Banking, which was down 40 per cent compared to 2012 given the improvement in the economic environment together with higher releases in 2013 compared to the same period in 2012. The significant improvement in the non-core impairment charge of 61 per cent compared to 2012 reflected reductions in the Corporate Real Estate and Irish portfolios following asset disposals.

Impaired loans as a percentage of closing advances reduced substantially to 6.3 per cent, from 8.6 per cent at 31 December 2012, driven by the reduced non-core portfolio and improvements in both the Retail and Commercial Banking portfolios. Provisions as a percentage of impaired loans increased from 48.2 per cent at 31 December 2012 to 50.1 per cent.

EXPOSURES SUBJECT TO THE INTERNAL RATINGS BASED APPROACH

The Group applies a variety of approaches for calculating credit risk capital requirements, a summary of which is provided below.

- **Standardised Approach:** portfolios on the Group's roll-out plan or that are permanently exempt from an IRB approach. Existing permanent exemptions comprise small portfolios and those closed to new business. The Group’s permanent exemption list together with the IRB roll-out plan are reviewed on a regular basis internally and by the PRA. A small number of portfolios have a deferred review date of 2015 agreed with the PRA. At this time a decision will be taken to place them on the roll-out plan or make them permanently exempt.

- **Foundation IRB Approach:** use of internal PD models together with regulatory defined credit conversion factors and LGD.

- **Regulatory IRB Supervisory Slotting Approach:** use of a methodology provided by the regulator for specialised lending portfolios.

- **Retail IRB Approach:** use of internal models to calculate PD, EAD and LGD for retail portfolios.

- **Other regulatory treatments:** the Simple Risk Weight method for equity exposures and alternative treatments for securitisation positions including the Internal Assessment Approach and the Ratings Based Approach, further details of which can be found in the Non-Trading Book Securitisations section of the document.

The Group operates a range of models for calculating credit risk capital requirements under the Foundation IRB and Retail IRB approaches.

The development, implementation and use of Foundation IRB and Retail IRB models are rigorously controlled through application of a Policy framework defining the Group's approach to data requirements, development, validation, governance and implementation for credit risk models.

Stringent internal independent assessment, approval and monitoring ensure IRB models are robust. Where appropriate, conservatism is applied to address modelling weaknesses to ensure capital adequacy. New IRB models and all material model changes are subject to additional scrutiny and approval by the PRA before they are implemented. If a model or data weakness is identified that indicates the understatement of capital, the capital requirements are adjusted, on a temporary basis, until the weakness is remediated. All such adjustments require senior management approval, and are subsequently monitored and reported to the PRA.

SCOPE OF THE IRB PERMISSION

The Group has regulatory approval to use its internal models in the calculation of the majority of its credit risk capital requirements. Compliance with the new Capital Requirements Regulation of CRD IV (effective from 1 January 2014) has been demonstrated by the grandfathering of the Group's previous permissions under the new regulatory regime by the PRA.

The following table summarises the principal portfolios within the Group that use the Retail IRB, Foundation IRB Regulatory IRB Supervisory Slotting and Standardised approaches.

Division	Retail IRB Approach	Foundation IRB Approach	Regulatory IRB Slotting Approach	Standardised Approach
Retail	The majority of Retail lending. UK Secured mortgage portfolios including Mainstream, Buy To Let and Self Certified UK Unsecured Credit Cards, Personal Current Accounts and Loans.	None	None	A minor proportion of Retail lending. Includes small, permanently exempt UK secured and unsecured portfolios and some on the IRB roll-out plan.
Commercial Banking [1]	A small proportion of Commercial Banking exposures meet the Retail SME definition.	A significant proportion of Commercial Banking lending, including corporates, banks, sovereigns, invoice discounting and other smaller portfolios.	A significant proportion of Commercial Banking portfolios defined by the regulator, consisting of property investment, property development, project finance and marine finance.	A smaller proportion of Commercial Banking portfolios, including some that are permanently exempt and some on the IRB roll-out plan.
WAFI [1]	A significant proportion of WAFI. Secured mortgage portfolios for Netherlands and Ireland. Asset Finance secured motor and personal finance portfolios.	A minor proportion of WAFI consisting mainly of the non-retail Asset Finance motor portfolio.	A minor proportion of WAFI portfolios defined by the regulator, consisting of property investment, property development, project finance and marine finance.	A significant proportion of WAFI is Standardised including some portfolios that are permanently exempt and some on the IRB roll-out plan.

Notes

[1] Includes equity exposures that are rated under the Simple Risk Weight Method.

Securitisation positions are subject to a range of risk weighting methodologies, including the Internal Assessment Approach, the Ratings Based Approach and the Standardised Approach. Further details can be found in the Securitisations section of the document.

INTERNAL DEVELOPMENT AND MONITORING OF IRB MODELS

The Group Risk Committee ('GRC') is designated as having direct responsibility for the establishment and review of the risk model governance framework and for the approval of the Group's most material risk models ('Level 1 models'). The GRC includes the Group Chief Executive, Chief Risk Officer and Group Finance Director. The GRC has delegated approval responsibility for all other models to the Model Governance Committee ('MGC'). The MGC comprises the Group Analytics and Modelling Director, Chief Credit Officer - Retail and Wealth and the Risk Director – Commercial Banking or their delegates, together with representatives from Risk Division, Finance Division and the appropriate, Business MD (or equivalent) or their delegates. The approval of each model requires support from the Designated Model Owner ('DMO') and the Business Model Owner ('BMO'). The DMO must attest on an annual basis and at times of model change that the risk model is fit for risk management.

The Group Model Governance Policy ('the Policy') sets out the control framework as well as establishing principles underpinning the technical standards that apply to IRB and other risk models. The Policy and supporting procedures cover: data integrity, model development and validation, monitoring, model review and approval, model implementation and usage.

An inventory of approved risk models is held centrally and is used to: ensure that models are reviewed annually, manage model actions and drive reporting. The reviews cover the aspects of the Policy and supporting manuals (described above) together with regulatory compliance.

Ongoing assessments of adherence to the Policy is undertaken through a combination of technical review forums, DMO assessment, the independent review and approval teams in the Risk Division and Internal Audit. Model risk is reported monthly to MGC and GRC with key risks reported through to the Board Risk Committee. Model performance monitoring is rigorously reviewed through divisional forums, with quarterly reporting to MGC and half yearly to GRC. Performance monitoring reporting is also provided to the PRA.

INTERNAL APPLICATION OF THE IRB APPROACH

In addition to the regulatory capital calculation process, IRB models are also widely used in the business.

Credit Approval

Risk Division sets out the Group credit principles and policy according to which credit risk is taken and 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 the responsibilities of lending officers and provides a disciplined and focused benchmark for credit decisions. IRB models are strongly linked with the credit approval process, although the precise nature differs between asset classes. For retail exposures, underlying application and behavioural scorecards (often used to make retail credit approval decisions) generate the PD component of the IRB model. For Commercial Banking exposures the PD model ascribes a credit risk grade to each customer and their exposures and this grade is used as a key input into the credit approval process.

Credit Limits

Prudent sanctioning and control procedures lie at the heart of the Group's credit regime with a variety of approaches appropriate to the product line, with the fundamental structure built upon:

- A risk differentiated, hierarchical approach to control, driven by size of exposure, credit risk grade, nature of risk and where appropriate lifetime expected losses ('LEL') measures, which are aligned with IRB models;
- 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 exposure (sovereign / bank / non bank) and dependent on the credit competence of the individuals concerned;
- Tight control procedures which must govern review frequency and account management responsibility; and
- Reporting protocols that ensure significant exposures, within the Group, are subject to additional monitoring and review.

Pricing

Pricing reflects the principle of risk / reward and the Risk Appetite defined by the Board. IRB outputs are considered in the assessment of the profitability of deals and products and to allow for risk-adjusted pricing and strategy decisions.

Portfolio Reporting

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

Calculating Impairment

The calculation of impairment levels within each portfolio is subject to rigorous challenge and oversight from both Finance and Risk. In some instances IRB model outputs are used to inform the impairment provisioning process or as direct inputs to impairment models.

MODEL CONSTRUCTION

Statistical techniques (predominantly regression) are used to construct capital models, but the actual methodology and approach used to construct individual models depends upon the availability of data, the history of the portfolio and the perceived sensitivity to the economic environment. This results in a suite of models that vary by customer type and lending product, which span the spectrum of:

- Purely data driven models e.g. in retail portfolios where a long time series of rich, abundant and representative data exists.

- Greater reliance on expert judgement and external benchmarking based models e.g. commercial portfolios where data is comparatively sparse.

In all instances appropriate levels of conservatism are included within the model build to cover any modelling weaknesses. This ensures that model outputs provide adequate capital requirements. The level to which any such conservatism is deemed adequate is robustly challenged through the Group's internal review and approval process and, ultimately, by the PRA.

PD models vary in their sensitivity to changes in the economy between the two extremes of Point-in-Time ('PiT' - changes in the economy are fully captured by changes in the PDs) and Through-the-Cycle ('TTC' - PDs are unaffected by changes in the economy) with some representing a hybrid position between the two extremes. Where possible, PDs are TTC calibrated. This approach aids capital management by ensuring the regulatory PD (and therefore the resultant regulatory capital requirements) fluctuates mainly due to changes in the credit quality mix of the portfolio, rather than changes in the economy.

The extent to which PDs are affected by changes in the economy primarily depends upon the data available to the model development and the calibration methodology chosen. For example:

- For many commercial portfolios the PDs are hybrid.

- Some secured retail portfolios adopt a Variable Scalar approved by the PRA to produce TTC PDs. For other retail portfolios the PDs are adjusted quarterly so that they equal the most recent observed default rates with a buffer to ensure conservatism if default rates change between calibrations i.e. they are effectively PiT.

Foundation IRB Ratings

The PD rating tools for publicly quoted, sovereigns and financial institutions portfolios place reliance on the history of external data and in particular the application of external ratings. The internal models seek to replicate the outputs of the External Credit Assessment Institutions ('ECAIs') and then apply this approach to all counterparties across the given portfolio.

For corporate exposures the LBG internal models are developed to take account of elements that are quantitative i.e. financial and behavioural ratio analysis; qualitative i.e. internal assessment of business management; and behavioural i.e. history of arrears (retail commercial exposures only). The specific measures and weighting of these components varies in relation to the particular scope of the model and portfolio to which it is being applied.

In certain circumstances there are portfolios where the observed number of defaults is low and in these cases the Group has followed appropriate steps to ensure the resulting model and calibration includes specific conservatism to reflect the degree of uncertainty in the available information. Where other weaknesses have been identified further suitable conservatism has been adopted to ensure the final calculation remains cautious.

The bank participates in the annual Hypothetical Portfolio Exercises ('HPEs') undertaken by the PRA and EBA. Outputs from these assist in benchmarking the Group's own models to those of the broader industry. Outcomes from the Group's sovereigns, banks and publicly quoted portfolio models are consistent with external ratings and in line with industry averages.

Retail IRB Ratings

There is extensive experience throughout the retail portfolios in the development, use and operation of credit models. Application scorecards are built to assist the assessment of new customers through use of historical performance data.

These scorecards are developed statistically using customer financial and demographic data supported by credit bureau information where available. Behavioural scorecards are similarly derived from historically observed performance based on a variety of customer financial and behavioural information. These tools further assist in the management of the existing portfolio.

Scorecard outputs are transformed through a calibration process into regulatory PD parameters.

The EAD models predict the balance at default by assessing changes in balance alongside behavioural elements specific to the operation of the product. Credit conversion factors are derived as necessary to reflect possible draw-down of approved limits prior to default.

The LGD models take account of the differing recovery processes and procedures associated with the different product lines. These include assessments of any underlying security, its variation in value over time and the ability to realise the collateral in an efficient manner. This is supplemented by the historic information available for fees, expenses, write offs and recoveries. These factors are discounted to reflect the opportunity cost for holding such assets over the period of the collection process.

Within the capital calculation the EAD and LGD output are adjusted to reflect the regulatory requirement to use values associated with an economic downturn. Where known weaknesses have been identified, either through a lack of available data or through changes to business activity (thus weakening the ability to use the past to predict the future), conservative assumptions have been used to ensure capital adequacy.

Key Characteristics of Material Group Ratings Systems

The table below shows key characteristics of the most significant models within the Group that drive the capital calculation. Models used in the calculation of regulatory capital are subject to parameters and floors as determined by the regulator.

Ratings System	Associated portfolio (RWAs)	Model	Model Description and Methodology	Number of years default data	Basel Asset Class
Unquoted	>£15bn	PD	Logistic regression model using a combination of financial and subjective factors.	12 years	Corporate
Publicly Quoted	>£15bn	PD	Logistic regression model using a combination of financial and subjective factors to predict ECAI ratings.	10 years	Corporate
Business Dynamic Credit Scoring (BDCS)	£5bn - £10bn	PD	Logistic regression model using a combination of behavioural and external data.	6 years	Corporate SME & Retail SME
		EAD	Regression model using customer behavioural information to calculate credit conversion factors. For customers already over (or close to) their limit, non-CCF approaches are used.		
		LGD	Regression model, using account behaviour characteristics, collateral and recoveries parameters. Models calibrated to downturn conditions as per regulatory requirements.		
Halifax Mainstream	£10bn - £15bn	PD	Logistic regression model based on application and behavioural scorecards, using both internal and external customer and account performance data, calibrated against internal long-run default data.	27 years	Retail Secured
Lloyds Bank Mortgages	£5bn - £10bn	EAD	Model factors include downturn interest rates, balance and arrears data.	11 years	
		LGD	Combines data-driven downturn estimates of loss given possession, distressed sale property values and probability of possession.		
HBOS Buy to Let Mortgages	£5bn - £10bn	PD	Logistic regression model based on application and behavioural scorecards, using both internal and external customer and account performance data, calibrated against the most recent internal default data with a buffer added to prevent underestimation risk between calibrations.	12 years	Retail Secured
HBOS Self Cert Mortgages	£5bn - £10bn	EAD	Model factors include downturn interest rates balance and arrears data to derive EAD.	10 years	
		LGD	Combines data driven downturn estimates of loss given possession, distressed sale property values and probability of possession.		
Bank of Scotland Ireland Mortgages	£5bn - £10bn	PD	Logistic regression model, using internal customer and account performance data, calibrated against the most recent internal default data with a buffer added to prevent underestimation risk between calibrations.	13 years	Retail Secured
		EAD	Model factors include downturn interest rates balance and arrears data to derive EAD.		
		LGD	Combines data driven downturn estimates of loss given possession, distressed sale property values and probability of possession.		
HBOS Credit Cards	£5bn - £10bn	PD	Logistic regression model based on application and behavioural scorecards, using both internal and external customer and account performance data, calibrated against the most recent internal default data with a buffer added to prevent underestimation risk between calibrations.	12 years	Qualifying Revolving Retail Exposure
		EAD	Linear regression models using balance, spend and headroom, calibrated to appropriate downturn values.		
		LGD	Combines data driven estimates of recovery rates and costs of recovery calibrated to appropriate downturn values.		
Lloyds Bank Personal Loans	£5bn - £10bn	PD	Logistic regression model based on application and behavioural scorecards, using both internal and external customer and account performance data, calibrated against the most recent internal default data with a buffer added to prevent underestimation risk between calibrations.	5 years	Other Retail
		EAD	Linear regression model using arrears data, interest rate and balance calibrated to appropriate downturn values.		
		LGD	Combines logistic regression models and other statistical techniques calibrated to appropriate downturn values.		

INTERNAL RATING SCALES

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

PD Master Scales

Corporate Master Scale

Table 32: **Corporate Master Scale**

PD Grades	Range			External S&P Rating (Approximate Equivalent)
	Lower	Mid	Upper	
1 - 4	0.000%	0.018%	0.035%	AAA to AA-
5	0.035%	0.043%	0.050%	A+
6	0.050%	0.065%	0.080%	A
7	0.080%	0.110%	0.140%	A-
8	0.140%	0.180%	0.220%	BBB+
9	0.220%	0.280%	0.340%	BBB
10	0.340%	0.420%	0.500%	BBB-
11	0.500%	0.630%	0.760%	BB+
12	0.760%	1.000%	1.240%	BB
13	1.240%	1.620%	2.000%	BB-
14	2.000%	2.600%	3.200%	B+
15	3.200%	4.200%	5.200%	B
16	5.200%	6.200%	7.200%	B
17	7.200%	8.700%	10.200%	B
18	10.200%	12.000%	13.800%	B-
19	13.800%	56.899%	99.999%	CCC to C
20 – 23 (Default)	100.000%	100.000%	100.000%	Default

Retail Master Scale

Table 33: **Retail Master Scale**

PD Grades	Range		
	Lower	Mid	Upper
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%	100.000%	100.000%

A detailed analysis, by PD Grade, of credit risk exposures subject to the Foundation IRB and Retail IRB approaches is provided in the sections that follow.

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 PD floors specified by regulators in respect of the calculation of regulatory capital requirements.

Corporate Exposures

As at 31 December 2013, corporate exposures subject to the Foundation IRB Approach totalled £103.4bn (2012: £121.1bn).

Corporate Main

Table 34: **Corporate Main exposures by PD grade**

PD Grades	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	11,409	0.03%	22.95%	11,341	0.03%	23.21%
5	3,381	0.04%	29.23%	5,913	0.04%	28.05%
6	7,805	0.07%	29.98%	6,715	0.06%	24.50%
7	11,178	0.11%	34.36%	6,986	0.09%	35.38%
8	11,905	0.17%	45.56%	9,702	0.14%	41.27%
9	8,844	0.27%	59.17%	10,031	0.22%	54.23%
10	9,837	0.43%	73.26%	9,015	0.37%	66.61%
11	4,263	0.67%	88.54%	5,541	0.56%	79.90%
12	4,677	1.06%	103.01%	4,665	0.87%	93.07%
13	3,027	1.69%	120.79%	4,919	1.52%	115.55%
14	1,990	2.69%	126.43%	2,738	2.30%	127.39%
15	289	4.22%	141.15%	2,078	3.61%	123.24%
16	1,843	5.62%	154.57%	875	5.69%	154.92%
17	133	8.56%	178.33%	1,567	8.23%	172.49%
18	261	12.87%	214.14%	1,159	12.03%	188.18%
19	903	31.16%	255.25%	1,897	32.26%	244.39%
20 – 23 (Default)	7,060	100.00%	-	9,766	100.00%	-
Total	88,805	8.78%	54.92%	94,908	11.73%	57.78%

Key Movements

- The reduction in the corporate main average risk weight from 57.78% to 54.92% reflects an overall improvement in the risk mix of the portfolio.

Corporate SME

Table 35: **Corporate SME exposures by PD grade**

PD Grades	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	184	0.03%	21.31%	464	0.03%	20.44%
5	170	0.04%	22.61%	359	0.04%	22.04%
6	733	0.06%	26.77%	565	0.06%	27.10%
7	290	0.11%	28.63%	184	0.11%	33.67%
8	207	0.17%	40.90%	267	0.18%	30.71%
9	571	0.27%	53.20%	600	0.28%	39.40%
10	1,211	0.44%	59.40%	961	0.38%	51.62%
11	1,921	0.65%	69.62%	2,210	0.58%	74.98%
12	1,866	1.10%	80.32%	1,751	0.86%	83.78%
13	1,388	1.68%	88.98%	1,149	1.71%	79.91%
14	1,837	2.68%	98.73%	1,769	2.10%	90.38%
15	178	4.07%	87.17%	1,331	3.36%	98.93%
16	961	5.73%	112.90%	605	5.57%	98.45%
17	172	8.48%	133.92%	1,001	8.25%	109.81%
18	575	12.14%	154.37%	1,419	12.17%	131.65%
19	460	26.20%	187.47%	639	28.97%	141.85%
20 – 23 (Default)	1,726	100.00%	-	3,779	100.00%	-
Total	14,450	14.58%	73.14%	19,053	22.61%	66.28%

Key Movements

- The increase in the corporate SME average risk weight from 66.28% to 73.14% primarily reflects the reduction in defaulted exposures following the reclassification of exposures to other exposure classes. Defaulted exposures do not receive a risk weight under the Foundation IRB Approach, being subject instead to a higher EL charge.

Corporate Specialised Lending

Table 36: **Corporate specialised lending exposures by PD grade**

PD Grades	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	156	0.06%	16.74%
7	-	-	-	134	0.11%	25.46%
8	-	-	-	308	0.17%	48.88%
9	1	0.29%	61.97%	1,105	0.29%	59.42%
10	1	0.45%	100.49%	944	0.44%	81.00%
11	7	0.67%	145.77%	928	0.67%	82.23%
12	16	0.99%	112.35%	642	0.98%	96.85%
13	15	1.39%	131.07%	589	1.41%	103.49%
14	22	2.57%	150.75%	675	2.37%	114.39%
15	14	3.86%	132.86%	373	3.86%	144.70%
16	-	-	-	-	-	-
17	-	-	-	-	-	-
18	-	-	-	202	10.72%	212.65%
19	-	-	-	-	-	-
20 – 23 (Default)	89	100.00%	-	1,054	100.00%	-
Total	165	55.77%	60.36%	7,110	15.96%	75.51%

Key Movements

- The vast majority of Foundation IRB corporate specialised lending portfolios were transitioned to the IRB Supervisory Slotting Approach during the year.

Central Government and Central Bank Exposures

As at 31 December 2013, central government and central bank exposures subject to the Foundation IRB Approach totalled £15.1bn (2012: £10.2bn).

Central Governments and Central Banks

Table 37: **Central government and central bank exposures by PD grade**

PD Grades	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	15,015	0.01%	10.43%	10,232	0.02%	14.38%
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	48	0.11%	27.42%	-	-	-
8	-	-	-	5	0.17%	28.58%
9	-	-	-	-	-	-
10	-	-	-	-	-	-
11	-	-	-	-	-	-
12	-	-	-	-	-	-
13	-	-	-	-	-	-
14	-	-	-	-	-	-
15	-	-	-	-	-	-
16	-	-	-	1	5.57%	154.95%
17	-	-	-	-	-	-
18	-	-	-	-	-	-
19	-	-	-	-	-	-
20 – 23 (Default)	-	-	-	-	-	-
Total	15,063	0.02%	10.48%	10,238	0.02%	14.04%

Key Movements

- The reduction in the average risk weight of central government and central bank exposures from 14.04% to 10.48% is a result of holding a higher proportion of short term deposits over longer term treasury bills at year end.

Institution Exposures

As at 31 December 2013, institution exposures subject to the Foundation IRB Approach totalled £5.3bn (2012: £5.7bn).

Institutions

Table 38: **Institution exposures by PD grade**

PD Grades	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	1,732	0.03%	6.66%	1,275	0.03%	9.51%
5	225	0.04%	28.64%	278	0.04%	16.96%
6	799	0.06%	15.05%	1,024	0.06%	18.43%
7	812	0.11%	24.14%	383	0.11%	27.90%
8	488	0.18%	35.59%	693	0.18%	35.80%
9	161	0.28%	46.96%	248	0.28%	40.56%
10	634	0.45%	32.86%	1,427	0.45%	28.97%
11	297	0.75%	71.43%	62	0.75%	35.22%
12	115	1.00%	80.39%	202	1.00%	75.18%
13	5	1.63%	93.39%	86	1.62%	34.98%
14	30	2.10%	139.15%	6	2.47%	132.48%
15	3	4.50%	137.10%	1	4.51%	128.46%
16	-	-	-	-	-	-
17	1	8.00%	172.87%	-	-	-
18	-	-	-	-	-	-
19	14	56.61%	202.38%	3	14.97%	218.08%
20 – 23 (Default)	2	100.00%	-	2	100.00%	-
Total	5,318	0.39%	25.17%	5,690	0.27%	25.43%

ANALYSIS OF EXPOSURES SUBJECT TO THE RETAIL IRB APPROACH

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

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

As at 31 December 2013, retail exposures subject to the Retail IRB Approach totalled £418.7bn (2012: £409.4bn).

Residential Mortgages

Table 39: **Residential mortgage exposures by PD grade**

PD Grade	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Exposure Weighted Average LGD [1] %	2013 Average Risk Weight %	2013 Undrawn Commitments (Gross) [2] £m	2013 Undrawn Commitments (Post Credit Conversion Factor) £m
0	119,417	0.10%	8.65%	2.08%	3,969	3,039
1	134,529	0.27%	10.71%	5.59%	4,360	3,700
2	42,853	0.71%	12.21%	13.41%	857	697
3	21,295	1.28%	12.94%	21.04%	1,764	971
4	14,172	2.51%	13.71%	33.84%	175	85
5	7,189	4.58%	13.98%	51.09%	197	146
6	4,438	8.65%	17.26%	88.20%	41	38
7	2,127	12.57%	18.66%	107.32%	7	4
8	2,604	15.55%	13.90%	89.42%	27	21
9	1,985	22.04%	14.88%	101.80%	14	12
10	2,160	32.05%	14.92%	95.82%	4	1
11	2,283	44.61%	16.01%	99.31%	12	8
12	2,116	68.40%	18.42%	72.38%	5	1
Default	6,921	100.00%	17.10%	106.98%	44	4
Total	364,089	3.66%	10.92%	14.42%	11,476	8,727

PD Grade	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Exposure Weighted Average LGD [1] %	2012 Average Risk Weight %	2012 Undrawn Commitments (Gross) [2] £m	2012 Undrawn Commitments (Post Credit Conversion Factor) £m
0	126,196	0.11%	8.46%	2.31%	2,964	1,998
1	116,819	0.29%	11.92%	6.95%	1,459	917
2	42,748	0.70%	13.35%	14.02%	646	509
3	20,275	1.29%	14.64%	22.50%	1,027	566
4	15,748	2.33%	15.60%	33.11%	1,753	1,127
5	5,855	4.37%	17.55%	55.12%	77	68
6	4,451	7.83%	18.98%	78.75%	40	38
7	2,988	11.86%	19.60%	95.17%	91	89
8	2,851	14.62%	20.28%	107.02%	24	21
9	2,254	22.51%	16.08%	95.44%	10	9
10	2,309	31.61%	17.16%	104.74%	1	-
11	2,766	43.14%	18.58%	107.06%	9	8
12	2,579	67.83%	20.93%	74.92%	2	1
Default	8,127	100.00%	19.48%	93.90%	14	5
Total	355,966	4.24%	11.85%	15.88%	8,117	5,356

Notes

[1] The 10% LGD floor that applies to residential mortgage exposures is applied at sub-portfolio level rather than at account level. The current and prior year exposure weighted average LGDs disclosed for PD Grade 0 fall below the floor as a result of the underlying accounts within the relevant sub-portfolios being allocated across the PD Grades. The accounts residing within PD Grade 0 represent the highest quality accounts within these sub-portfolios and may individually receive an LGD of less than 10%. However, the LGD for the entire sub-portfolio in which these accounts reside is floored at 10%.

[2] Undrawn commitments predominantly relate to pipeline mortgages.

Key Movements

- The average risk weight for IRB residential mortgage exposures reduced from 15.88% to 14.42% during the year, primarily reflecting improvements in credit quality through effective portfolio management and the impact of positive macroeconomic factors, including favourable movements in UK house prices, partially offset by additional risk weighted assets arising from the BOS Netherlands model roll out. The Group continually reviews the capital it holds against IRB residential mortgage exposures, utilising its deep experience and understanding of the UK housing market and its assessment of future potential losses to assess the appropriateness of the level of capital held. In addition the Group's residential mortgage models are subject to rigorous internal review and external review and approval by the PRA. The Group remains comfortable that the level of capital resources allocated to support its mortgage business remains appropriate.

- The significant migration of exposures from PD Grade 0 to PD Grade 1 during 2013 predominantly results from ongoing model review and is reflective of up-to-date and prudent risk categorisation of the exposures. In addition, the increase in PD Grade 1 reflects both an increase in new lending and the inclusion of a significant proportion of the exposures associated with the BOS Netherlands IRB model roll out.

- Gross undrawn commitments increased by £3.4bn during the year reflecting a growth in core lending new business driven by increased consumer demand and an improving UK housing market.

Table 40: **Residential mortgage exposures by major portfolio**

Major Portfolio	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Exposure Weighted Average LGD [1] %	2013 Average Risk Weight %	2013 Undrawn Commitments (Gross) £m	2013 Undrawn Commitments (Post Credit Conversion Factor) £m
UK Prime	273,132	2.93%	9.90%	10.19%	8,484	6,951
UK Buy-to-Let	47,522	2.44%	13.27%	11.55%	1,693	916
UK Self Certified	21,527	8.73%	11.01%	23.16%	457	30
Irish Mortgages [2]	5,093	24.66%	32.54%	156.70%	-	-
Dutch Mortgages [3]	5,325	3.18%	21.93%	27.53%	96	96
Other Mortgages [4]	11,490	7.49%	10.67%	41.42%	746	734
Total	364,089	3.66%	10.92%	14.42%	11,476	8,727

Major Portfolio	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Exposure Weighted Average LGD [1] %	2012 Average Risk Weight %	2012 Undrawn Commitments (Gross) £m	2012 Undrawn Commitments (Post Credit Conversion Factor) £m
UK Prime	273,803	3.20%	10.56%	11.70%	6,078	4,052
UK Buy-to-Let	43,754	3.28%	16.07%	16.69%	896	459
UK Self Certified	22,796	9.64%	12.93%	27.92%	314	37
Irish Mortgages [2]	5,582	29.51%	37.75%	138.90%	-	-
Dutch Mortgages [3]	-	-	-	-	-	-
Other Mortgages [4]	10,031	10.34%	11.49%	30.67%	829	808
Total	355,966	4.24%	11.85%	15.88%	8,117	5,356

Notes

[1] The 10% LGD floor that applies to residential mortgage exposures is applied at sub-portfolio level rather than the segments (‘major portfolios’) referred to in the table above. UK Prime is a segment of a number of sub-portfolios, hence LGD’s are below the floor as a result of the underlying accounts within this segment. UK Prime represents the highest quality accounts within these sub-portfolios and may individually receive an LGD of less than 10%. However, the LGD for the entire sub-portfolio in which these accounts reside is floored at 10%. The year-on-year reduction in average LGDs principally reflects the impact of House Price Inflation – for the UK Prime segment this reduced the LGD from above the 10% floor in 2012 to just below in 2013.

[2] For the Irish residential mortgages portfolio, the higher average risk weight in 2013 follows an upward adjustment to reported capital requirements pending approval and implementation of a new IRB capital model. In the meantime, the lower average PD and LGD reported for 2013 reflect the existing IRB capital model. The approach taken, to increase RWA and EL by way of a portfolio level overlay whilst leaving the underlying models unchanged (including PD, LGD and EAD), is in line with the requirements of PRA Supervisory Statement SS11/13 (‘Internal Ratings Based Approaches’), published in December 2013.

[3] The BOS Netherlands IRB residential mortgage model was rolled out during 2013.

[4] Other mortgages predominantly comprises of Commercial Banking loans secured by mortgages on residential property.

Qualifying Revolving Retail Exposures

Table 41: **Qualifying revolving retail exposures by PD grade**

PD Grade	2013 Credit Risk Exposure	2013 Exposure Weighted Average PD	2013 Exposure Weighted Average LGD	2013 Average Risk Weight	2013 Undrawn Commitments (Gross)	2013 Undrawn Commitments (Post Credit Conversion Factor) [1]
	£m	%	%	%	£m	£m
0	8,070	0.05%	78.36%	2.88%	8,809	7,884
1	10,525	0.22%	76.27%	9.32%	16,939	9,192
2	4,569	0.58%	77.55%	20.50%	5,836	3,385
3	2,258	1.00%	78.34%	31.76%	2,214	1,465
4	3,713	1.77%	78.50%	48.71%	2,828	2,024
5	2,828	3.38%	78.31%	77.12%	1,425	1,099
6	2,581	6.02%	77.61%	112.33%	1,205	804
7	869	8.59%	78.91%	142.53%	203	239
8	923	11.93%	78.89%	171.56%	210	317
9	517	16.47%	78.62%	200.46%	86	108
10	331	24.15%	78.47%	232.51%	41	61
11	197	35.95%	78.69%	253.18%	21	34
12	184	66.54%	79.03%	186.30%	13	28
Default	787	100.00%	47.56%	143.31%	48	-
Total	38,352	4.49%	77.05%	42.64%	39,878	26,640

PD Grade	2012 Credit Risk Exposure	2012 Exposure Weighted Average PD	2012 Exposure Weighted Average LGD	2012 Average Risk Weight	2012 Undrawn Commitments (Gross)	2012 Undrawn Commitments (Post Credit Conversion Factor) [1]
	£m	%	%	%	£m	£m
0	7,446	0.05%	74.94%	2.89%	10,166	7,154
1	7,461	0.22%	78.22%	9.68%	8,625	6,968
2	5,397	0.56%	76.20%	20.08%	10,665	4,201
3	2,246	0.98%	76.95%	31.45%	2,539	1,513
4	3,819	1.77%	77.53%	48.84%	3,397	2,096
5	3,054	3.37%	77.84%	77.76%	1,812	1,164
6	2,523	5.92%	77.49%	112.45%	1,092	709
7	1,399	8.39%	77.43%	141.24%	335	372
8	753	11.75%	78.42%	171.40%	139	151
9	528	16.57%	78.66%	203.88%	75	99
10	353	24.19%	78.52%	235.72%	37	58
11	213	35.99%	78.54%	255.02%	19	33
12	210	65.62%	78.66%	190.94%	12	30
Default	903	100.00%	54.67%	148.14%	58	-
Total	36,305	5.20%	76.42%	47.55%	38,971	24,548

Notes

[1] Undrawn commitments post credit conversion can exceed the gross undrawn equivalents where there is an assumption that future drawings will be higher than the current limit.

Key Movements

- The reduction in the overall average risk weight from 47.55% to 42.64% reflects an improved risk mix within the credit cards and personal current accounts portfolios.

Other Retail

Table 42: **Other retail exposures by PD grade**

PD Grade	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Exposure Weighted Average LGD %	2013 Average Risk Weight %	2013 Undrawn Commitments (Gross) £m	2013 Undrawn Commitments (Post Credit Conversion Factor) £m
0	**8**	**0.08%**	**80.09%**	**18.58%**	**-**	**-**
1	**1,375**	**0.35%**	**47.34%**	**28.23%**	**4**	**1**
2	**930**	**0.64%**	**74.64%**	**64.42%**	**8**	**2**
3	**936**	**1.02%**	**85.43%**	**92.87%**	**7**	**1**
4	**4,320**	**1.74%**	**70.24%**	**92.55%**	**16**	**3**
5	**2,318**	**3.32%**	**88.56%**	**132.96%**	**11**	**2**
6	**1,714**	**5.94%**	**77.73%**	**124.35%**	**10**	**2**
7	**359**	**8.61%**	**90.57%**	**155.36%**	**2**	**-**
8	**236**	**11.63%**	**91.25%**	**172.58%**	**2**	**-**
9	**127**	**16.71%**	**91.42%**	**201.77%**	**1**	**-**
10	**128**	**22.10%**	**62.38%**	**154.83%**	**-**	**-**
11	**137**	**34.61%**	**60.30%**	**167.57%**	**-**	**-**
12	**125**	**73.15%**	**83.44%**	**146.48%**	**6**	**3**
Default	**678**	**100.00%**	**52.77%**	**113.48%**	**-**	**-**
Total	**13,391**	**8.95%**	**73.57%**	**102.09%**	**67**	**14**

PD Grade	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Exposure Weighted Average LGD %	2012 Average Risk Weight %	2012 Undrawn Commitments (Gross) £m	2012 Undrawn Commitments (Post Credit Conversion Factor) £m
0	2	0.09%	79.55%	19.28%	-	-
1	1,164	0.34%	52.64%	30.75%	5	1
2	980	0.63%	77.50%	66.29%	11	2
3	1,107	1.02%	85.78%	92.79%	10	2
4	4,637	1.75%	75.02%	98.57%	20	4
5	2,494	3.33%	89.74%	134.11%	14	3
6	1,648	5.89%	78.44%	124.78%	8	2
7	389	8.53%	90.79%	154.40%	2	-
8	207	11.56%	91.05%	170.66%	1	-
9	172	17.64%	90.91%	203.22%	4	1
10	158	21.82%	65.83%	161.47%	-	-
11	220	39.60%	69.89%	194.66%	4	2
12	161	71.80%	82.90%	158.08%	1	-
Default	967	100.00%	59.58%	99.03%	-	-
Total	14,306	11.01%	76.88%	106.29%	80	17

Key Movements

- The reduction in the overall average risk weight from 106.29% to 102.09% reflects an improved risk mix within the personal loans portfolio.

Retail SME

Table 43: **Retail SME exposures by PD grade**

PD Grade	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Exposure Weighted Average LGD %	2013 Average Risk Weight %	2013 Undrawn Commitments (Gross) £m	2013 Undrawn Commitments (Post Credit Conversion Factor) £m
0	-	-	-	-	-	-
1	-	-	-	-	-	-
2	376	0.61%	49.76%	67.97%	484	484
3	598	1.12%	53.88%	77.39%	185	185
4	332	1.67%	55.59%	93.35%	80	80
5	398	2.62%	56.13%	103.38%	68	68
6	255	5.67%	57.73%	114.42%	45	45
7	99	8.04%	57.10%	126.86%	7	7
8	179	10.61%	63.12%	138.31%	29	29
9	91	18.02%	68.58%	183.06%	10	10
10	-	-	-	-	-	-
11	41	34.10%	67.43%	220.91%	3	3
12	27	78.18%	62.24%	114.62%	4	4
Default	468	100.00%	3.89%	44.50%	3	3
Total	2,864	20.40%	47.45%	90.78%	918	918

PD Grade	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Exposure Weighted Average LGD %	2012 Average Risk Weight %	2012 Undrawn Commitments (Gross) £m	2012 Undrawn Commitments (Post Credit Conversion Factor) £m
0	-	-	-	-	-	-
1	-	-	-	-	-	-
2	751	0.62%	53.39%	70.92%	592	559
3	415	1.14%	58.91%	85.77%	216	210
4	231	1.69%	60.96%	96.23%	96	95
5	284	2.64%	63.78%	106.66%	84	83
6	187	5.73%	65.54%	118.53%	57	56
7	215	8.03%	60.32%	119.96%	103	103
8	129	10.79%	72.10%	143.74%	36	35
9	68	18.49%	76.68%	183.83%	13	13
10	-	-	-	-	-	-
11	33	34.93%	78.29%	225.78%	5	4
12	17	79.59%	82.92%	155.16%	6	3
Default	480	100.00%	3.26%	30.76%	2	2
Total	2,810	20.65%	50.53%	87.24%	1,210	1,163

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

Corporate Specialised Lending Exposures Subject to Supervisory Slotting

Corporate specialised lending exposures subject to the IRB Supervisory Slotting Approach 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 that applies 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 2013, corporate specialised lending exposures subject to supervisory slotting amounted to £33.2bn (2012: £6.9bn). Risk weighted assets arising from this amounted to £20.5bn (2012: £4.9bn) as analysed in the table below.

Table 44: **Corporate specialised lending exposures subject to supervisory slotting**

Grade	Remaining Maturity <2.5 years 2013 Exposure £m	Remaining Maturity <2.5 years 2013 Risk Weighted Assets £m	Remaining Maturity >2.5 years 2013 Exposure £m	Remaining Maturity >2.5 years 2013 Risk Weighted Assets £m
1) Strong	1,511	756	5,830	4,082
2) Good	3,282	2,297	4,399	3,899
3) Satisfactory	1,747	2,009	3,041	3,497
4) Weak	402	1,004	1,187	2,967
5) Default [1]	4,919	-	6,859	-
Total	11,861	6,066	21,316	14,445

Grade	Remaining Maturity <2.5 years 2012 Exposure £m	Remaining Maturity <2.5 years 2012 Risk Weighted Assets £m	Remaining Maturity >2.5 years 2012 Exposure £m	Remaining Maturity >2.5 years 2012 Risk Weighted Assets £m
1) Strong	240	80	1,639	691
2) Good	900	613	2,560	2,215
3) Satisfactory	498	573	528	607
4) Weak	21	51	27	67
5) Default [1]	397	-	46	-
Total	2,056	1,317	4,800	3,580

[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.

Key Movement

- Supervisory slotting exposures increased from £6.9bn to 33.2bn during the year, with an increase in RWAs from £4.9bn to £20.5bn. The increases are primary driven by the transitioning of Standardised Approach and Foundation IRB Approach commercial real estate portfolios to the IRB Supervisory Slotting Approach in line with PRA requirements. Exposures categorised as defaulted are substantially provided against as highlighted on page 69.

Equity Exposures Subject to the Simple Risk Weight Method

As at 31 December 2013, total credit risk exposures in respect of equities subject to the Simple Risk Weight Method amounted to £2.9bn (2012: £2.8bn). Risk weighted assets arising from this amounted to £5.9bn (2012: £5.7bn).

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

Table 45: **Equity exposures subject to the Simple Risk Weight Method**

	2013 Credit Risk Exposure £m	2013 Risk Weighted Asset £m	2012 Credit Risk Exposure £m	2012 Risk Weighted Asset £m
Privately traded equity exposures – 190% [1]	2,705	5,140	2,591	4,917
Publicly traded equity exposures – 290%	106	307	86	248
Other equity exposures – 370%	123	455	147	544
Total	2,934	5,902	2,824	5,709

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

Further information on non-trading book exposures in equities is provided on page 78.

COMPARISON OF EXPECTED LOSSES TO ACCOUNTING ALLOWANCE FOR IMPAIRMENT LOSSES

The table on page 69 provides a comparison of regulatory expected losses to the accounting allowance for impairment losses on loans and receivables (impairment provisions), in respect of credit risk exposures subject to the IRB Approach.

The definition, calculation and treatment of regulatory expected losses are covered on page 9.

In comparing regulatory expected losses to accounting measures of impairment, significant differences in the calculation and scope of each must be taken into account. IRB models are developed to meet precise regulatory requirements and as such the expected losses generated by these models are not directly comparable to impairment losses or allowances derived under current IFRS accounting standards. In particular;

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

- Regular detailed analysis of modelled impairment allowance outputs is undertaken to ensure that the models adequately capture all incurred losses. Where this is considered not to be the case, additional accounting impairment allowances are applied to capture the risk.

- Regulatory expected losses generated under the Foundation IRB Approach make use of LGD parameters and credit conversion factors (applied in the calculation of EAD) that are set by the regulator. The assumptions inherent within these regulatory measures may differ significantly to the assumptions applied when estimating future cash flows for use in accounting impairment loss calculations.

- Regulatory expected loss calculations forecast potential losses arising from all accounts including those that currently exhibit no indication of impairment.

- Regulatory expected losses in relation to portfolios that are based on Through-the-Cycle ('TTC') PD estimates utilise historic default experience, whereas accounting impairment losses and allowances are based on the losses that have been incurred at the balance sheet date.

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

- In certain cases regulatory expected losses are determined through the application of a fixed percentage applied to the exposure, for example expected losses calculated in respect of corporate specialised lending exposures subject to the IRB Supervisory Slotting Approach.

In addition, regulatory 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. Accounting impairment losses for the year will reflect losses in relation to all portfolios that were subject to the IRB Approach during the year. In comparing regulatory expected losses to the accounting allowance for impairment losses, consideration of the above should be taken into account.

Table 46: **Regulatory expected losses and allowances for impairment losses**

	Regulatory Expected Losses as at 31 December 2013 £m	Allowance for Impairment Losses on Loans and Receivables as at 31 December 2013 £m	Regulatory Expected Losses as at 31 December 2012 £m	Allowance for Impairment Losses on Loans and Receivables as at 31 December 2012 £m	Regulatory Expected Losses as at 31 December 2011 £m	Allowance for Impairment Losses on Loans and Receivables as at 31 December 2011 £m
Foundation IRB Approach						
Corporates	4,336	3,823	6,910	5,936	9,057	7,553
Central governments and central banks	1	-	1	-	1	-
Institutions	8	-	5	4	39	86
Retail IRB Approach						
Retail - Residential mortgages	1,967	2,123	2,270	2,562	2,275	2,507
Retail - Qualifying revolving retail exposures	911	379	1,057	456	1,414	682
Retail - Other retail	638	371	871	530	1,324	807
Retail - SME	90	26	85	20	79	24
Other IRB Approaches						
Corporate - Specialised lending	5,805	6,132	335	215	331	148
Equities	25	-	24	-	-	-
Fair value adjustments [1]	(668)	-	(702)	-	(1,408)	-
Total [2]	13,113	12,854	10,856	9,723	13,112	11,807
Standardised Approach and other exposures [3]		2,997		13,084		17,181
Fair value and other adjustments		(3,760)		(7,348)		(9,966)
Total per Statutory Consolidated Balance Sheet		12,091		15,459		19,022

Notes

[1] The calculation of excess expected loss ('EEL') amounts, where regulatory expected losses are netted against the allowance for impairment losses on IRB portfolios, is subject to the application of acquisition related fair value adjustments.

[2] The analysis provided excludes regulatory expected losses arising on counterparty credit risk exposures that amounted to £488m at 31 December 2013 (2012: £139m; 2010: £135m). The increase in regulatory expected losses was primarily a result of the transfer of Standardised Approach counterparty credit risk portfolios to IRB Approach models during the year, as detailed on page 102.

[3] Other exposures include debt securities categorised as securitisation positions under the IRB Approach.

❖ Further details on the fair value and other adjustments applied in respect of impairment losses charged to the income statement and allowances for impairment losses on loans and receivables can be found on pages 141 and 330, respectively, of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

Key Movements

- Regulatory expected losses for Foundation IRB corporates reduced from £6.9bn to £4.3bn, primarily as a result of the reduction in Foundation IRB corporate exposures during the year, in particular defaulted exposures, resulting from non-core portfolio disposals, asset run-off and the transitioning of Foundation IRB corporate specialised lending portfolios (primarily commercial real estate) to the IRB Supervisory Slotting Approach. The related allowance for impairment losses reduced from £5.9bn to £3.8bn for similar reasons.

- The Group continues to maintain a prudent provisioning policy over residential mortgage portfolios, resulting in the allowance for impairment losses exceeding regulatory expected losses for Retail IRB residential mortgage portfolios across the last three years. Regulatory expected losses on other Retail IRB portfolios remain in excess of related allowances for impairment losses, reflecting the impact of model conservatism.

- Regulatory expected losses for corporate specialised lending exposures subject to the IRB Supervisory Slotting Approach increased from £0.3bn to £5.8bn, with the related allowance for impairment losses increasing from £0.2bn to £6.1bn. This reflects the transitioning of corporate specialised lending portfolios (primarily commercial real estate) from other exposure classes under the Standardised Approach and Foundation IRB Approach. Regulatory expected losses under the IRB Supervisory Slotting approach are based on fixed percentages, capped at 50% for defaulted exposures.

- At 31 December 2013, the overall allowance for impairment losses on IRB portfolios (excluding CCR) amounted to 98% (2012: 90%; 2011: 90%) of the total regulatory expected loss (net of fair value adjustments).

MODEL PERFORMANCE

This section provides an analysis of the performance of IRB models over 2013.

The table below outlines the estimated and actual Probability of Default ('PD'), Loss Given Default ('LGD'), and Exposure at Default ('EAD') ratio by exposure class. The values are taken from the Group's regulatory capital calculation models, including the application of regulatory floors**.** No LGD or EAD information is provided for the Commercial Business element of the table as these parameters are not modelled under the Foundation IRB Approach.

The calculations shown consider the portfolio of non-defaulted exposures at the start of the period and compare the default level for the following year predicted by the Expected Loss component models with the actual exposure classified as defaulted 12 months later.

For the purposes of comparison, EAD weighting has been used throughout. This approach can be sensitive to small numbers of high value defaults.

Table 47: **Model performance**

IRB Exposure Class	Probability of Default		Loss Given Default of Defaulted Assets		EAD of Defaulted Assets
	Estimated Dec 12 %	Actual Dec 13 %	Estimated Dec 12 %	Actual Dec 13 %	Ratio of Predicted to Actual %
Commercial Business					
Central governments and central banks	0.02%	0.00%			
Institutions	0.20%	0.02%			
Corporates [1]	1.89%	1.88%			
Retail Business					
Residential mortgages	2.12%	1.37%	15.85%	7.09%	1.03
Qualifying revolving retail exposures	2.84%	2.60%	78.56%	68.88%	1.07
Other retail	4.91%	4.69%	81.56%	68.91%	1.09
Retail SME	4.17%	3.13%	63.13%	66.03%	1.04

Notes

[1] Commercial Real Estate portfolios were transferred to the IRB Supervisory Slotting Approach during the year and are therefore excluded from the analysis.

IRB Exposure Class	Probability of Default		Loss Given Default of Defaulted Assets		EAD of Defaulted Assets
	Estimated Dec 11 %	Actual Dec 12 %	Estimated Dec 11 %	Actual Dec 12 %	Ratio of Predicted to Actual %
Commercial Business					
Central governments and central banks	0.03%	0.00%			
Institutions	0.08%	0.00%			
Corporates	2.05%	2.76%			
Retail Business					
Residential mortgages	2.15%	1.50%	16.08%	8.04%	1.03
Qualifying revolving retail exposures	3.38%	2.77%	78.71%	66.54%	1.10
Other retail	5.98%	5.01%	81.74%	66.36%	1.09
Retail SME	4.51%	3.95%	64.44%	63.17%	1.05

IRB Exposure Class	Probability of Default		Loss Given Default of Defaulted Assets		EAD of Defaulted Assets
	Estimated Dec 10 %	Actual Dec 11 %	Estimated Dec 10 %	Actual Dec 11 %	Ratio of Predicted to Actual %
Commercial Business					
Central governments and central banks	0.02%	0.00%			
Institutions	0.10%	0.00%			
Corporates	3.17%	5.27%			
Retail Business					
Residential mortgages	2.29%	1.35%	16.34%	8.51%	1.02
Qualifying revolving retail exposures	3.79%	3.48%	79.41%	69.95%	1.09
Other retail	6.79%	6.16%	86.89%	69.89%	1.07
Retail SME	6.73%	4.47%	62.68%	74.72%	1.06

A number of factors impact on the metrics shown, for example changes in portfolio composition arising from risk appetite realignment, changes in the risk profile of the portfolio, economic factors, movement in individual model parameters and conservatism within the models. Models are refreshed through recalibration or replacement as required and during 2013 the process to integrate models has continued to make significant progress.

If model validation indicates an understatement of capital then capital requirements are adjusted, on a temporary basis, until remedied. The validation of models and outputs forms part of the control framework surrounding the development and monitoring of IRB models described on pages 52 to 56.

The models and rating systems vary between using a Point-in-Time ('PiT') and a Through-the-Cycle ('TTC') approach with many representing a hybrid position. Within the Group, the PD models used in the regulatory capital calculation seek to be through-the-cycle calibrated or hybrid models where possible. As a result, whilst having the same average over a full economic cycle as the actual default rates, model PDs have lower variability. The gap between estimated and actual default rates will therefore narrow or widen to reflect the cyclical nature of defaults.

For those assets where losses are not yet realised the determination of actual LGD includes estimates of future recoveries.

The EAD ratio is provided as a proxy for the regulatory requirement to disclose information about credit conversion factors. The ratio is provided as it allows a consistent measurement to be produced across all parts of the Bank, and the Group believes this to be a more useful measure. Where the predicted EAD was greater than the actual exposure on the date of default, the ratio will be greater than one.

EXPOSURES SUBJECT TO THE STANDARDISED APPROACH

As at 31 December 2013, credit risk exposures risk weighted under the Standardised Approach amounted to £132.5bn (2012: £183.1bn), generating risk weighted assets of £41.2bn (2012: £73.7bn) and a capital requirement of £3.3bn (2012: £5.9bn).

The Group makes limited use of credit assessments by external credit assessment institutions ('ECAIs') to assign risk weights to credit risk exposures under the Standardised Approach. This typically applies in the case of certain central government and central bank and institution exposures. Where available, credit assessments can also be used to assign risk weights to exposures to corporates and collective investment undertakings.

Where a credit assessment is used this must be provided by an eligible ECAI from the PRA's approved list. The appropriate risk weight to apply to the credit risk exposure is determined by assigning the exposure to the relevant credit quality step under BIPRU Chapter 3 (Standardised Credit Risk), based on the PRA's mapping of credit assessments to credit quality steps. A table containing the current mappings is published on the PRA's website. Where appropriate, the Group makes use of credit assessments provided by Standard & Poor's, Moody's and Fitch.

The majority of the Group's Standardised credit risk exposures are deemed to be unrated as there are no available credit assessments to utilise. Risk weights are assigned to these exposures in accordance with BIPRU Chapter 3 requirements prescribing the treatment of 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 appropriate risk weight is applied to the exposure after consideration of any eligible forms of credit risk mitigation.

Key movements in Standardised credit risk exposures are explained on page 38.

Central Governments and Central Banks

Table 48: **Standardised central government and central bank exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	78,474	-	78,474	-
100%	49	-	49	49
Total	**78,523**	**-**	**78,523**	**49**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	92,989	(1)	92,988	-
100%	105	-	105	105
Total	93,094	(1)	93,093	105

Regional Governments and Local Authorities

Table 49: **Standardised regional government and local authority exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
20%	-	-	-	-
100%	-	-	-	-
Total	**-**	**-**	**-**	**-**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
20%	30	-	30	6
100%	12	-	12	12
Total	42	-	42	18

Administrative Bodies and Non-Commercial Undertakings

Table 50: **Standardised administrative body and non-commercial undertaking exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
20%	-	-	-	-
100%	9	-	9	9
Total	**9**	**-**	**9**	**9**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
20%	17	-	17	3
100%	59	-	59	59
Total	76	-	76	62

Multilateral Development Banks

Table 51: **Standardised multilateral development bank exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	-	-	-	-
Total	**-**	**-**	**-**	**-**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	83	-	83	-
Total	83	-	83	-

Institutions

Table 52: **Standardised institution exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	-	-	-	-
20%	677	-	677	135
50%	222	-	222	111
100%	49	-	49	49
Total	**948**	**-**	**948**	**295**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	11	-	11	-
20%	699	-	699	140
50%	130	-	130	65
100%	361	-	361	361
Total	1,201	-	1,201	566

Corporates

Table 53: **Standardised corporate exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	-	-	-	-
20%	161	-	161	32
50%	1,342	-	1,342	671
100%	9,341	(7)	9,334	9,334
150%	-	-	-	-
Other [1]	7,510	(1,262)	6,248	6,937
Total	**18,354**	**(1,269)**	**17,085**	**16,974**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	42	-	42	-
20%	20	-	20	4
50%	1,438	-	1,438	719
100%	10,489	(289)	10,200	10,200
150%	14	-	14	21
Other [1]	15,287	(1,619)	13,668	14,593
Total	27,290	(1,908)	25,382	25,537

Notes

[1] Includes exposures to corporates, primarily held within Commercial Banking Division, where the risk weighted asset amounts have been determined in accordance with Standardised Approach requirements, supplemented by additional conservative estimates.

Exposures to corporates amounting to £nil (2012: £42m) are covered by an export credits guarantee from the UK Export Finance, Export Credit Guarantee Department ('ECGD'). A risk weight of 0% has been applied to these exposures.

Retail

Table 54: **Standardised retail exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	-	-	-	-
75%	5,220	-	5,220	3,915
100%	98	-	98	98
150%	7	-	7	10
Total	**5,325**	**-**	**5,325**	**4,023**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	54	-	54	-
75%	7,095	(55)	7,040	5,279
100%	323	(9)	314	314
150%	7	-	7	11
Total	7,479	(64)	7,415	5,604

Secured by Mortgages on Residential Property

Table 55: **Standardised exposures secured by mortgages on residential property by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	-	-	-	-
35%	6,759	-	6,759	2,365
50%	339	-	339	170
75%	-	-	-	-
100%	-	-	-	-
Other [1]	-	-	-	-
Total	7,098	-	7,098	2,535

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	443	-	443	-
35%	11,089	-	11,089	3,881
50%	726	-	726	363
75%	3,300	-	3,300	2,475
100%	1	-	1	1
Other [1]	332	-	332	230
Total	15,891	-	15,891	6,950

Notes

[1] As at 31 December 2012 this included lifetime mortgage exposures that were subject to non-standard risk weights. During 2013 the risk weight treatment was amended and standard risk weights applied.

Exposures secured by mortgages on residential property amounting to £nil (2012: £443m) are covered by a guarantee provided through a Dutch Government scheme. A risk weight of 0% has been applied to these exposures.

Secured by Mortgages on Commercial Real Estate

Table 56: **Standardised exposures secured by mortgages on commercial real estate by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
100%	163	-	163	163
150%	28	-	28	43
Other [1]	-	-	-	-
Total	191	-	191	206

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
100%	2,789	(9)	2,780	2,780
150%	-	-	-	-
Other [1]	11,032	-	11,032	12,420
Total	13,821	(9)	13,812	15,200

Notes

[1] As at 31 December 2012 this included commercial real estate exposures, primarily held within Commercial Banking Division, where the risk weighted asset amounts were determined in accordance with Standardised Approach requirements, supplemented by additional conservative estimates. During 2013 these exposures were transitioned to the IRB Supervisory Slotting Approach.

Past Due Items

Table 57: **Standardised past due items by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	-	-	-	-
35%	6	-	6	2
50%	6	-	6	3
100%	1,382	(5)	1,377	1,377
150%	906	-	906	1,360
Total	**2,300**	**(5)**	**2,295**	**2,742**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	2	-	2	-
35%	-	-	-	-
50%	42	-	42	21
100%	3,837	(2)	3,835	3,835
150%	1,625	(50)	1,575	2,362
Total	5,506	(52)	5,454	6,218

Notes

Past due items amounting to £nil (2012: £2m) are covered by government guarantees that allow a risk weight of 0% to be applied.

Items Belonging to Regulatory High Risk Categories

Table 58: **Standardised items belonging to regulatory high risk categories by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
150%	1	-	1	1
Total	**1**	**-**	**1**	**1**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
150%	1	-	1	1
Total	1	-	1	1

Short Term Claims on Institutions or Corporates

Table 59: **Standardised short term claims on institutions and corporates by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
100%	819	-	819	819
150%	7	-	7	11
Total	**826**	**-**	**826**	**830**

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
100%	164	-	164	164
150%	15	-	15	23
Total	179	-	179	187

Collective Investment Undertakings

Table 60: **Standardised collective investment undertaking exposures by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
20%	241	-	241	49
100%	-	-	-	-
Total	241	-	241	49

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
20%	260	-	260	52
100%	1	-	1	1
Total	261	-	261	53

Other Items

Table 61: **Standardised other items by risk weight**

Risk Weight	2013 Credit Risk Exposure (Pre CRM) £m	2013 Credit Risk Mitigation £m	2013 Credit Risk Exposure (Post CRM) £m	2013 Risk Weighted Asset £m
0%	3,944	-	3,944	-
20%	991	-	991	198
100%	12,162	-	12,162	12,162
Other [1]	1,560	-	1,560	1,077
Total	18,657	-	18,657	13,437

Risk Weight	2012 Credit Risk Exposure (Pre CRM) £m	2012 Credit Risk Mitigation £m	2012 Credit Risk Exposure (Post CRM) £m	2012 Risk Weighted Asset £m
0%	3,855	-	3,855	-
20%	1,117	-	1,117	223
100%	12,406	-	12,406	12,406
Other [1]	817		817	535
Total	18,195	-	18,195	13,164

Notes

[1] Includes residual values of operating lease assets that are subject to non-standard risk weights.

NON-TRADING BOOK EXPOSURES IN EQUITIES

Non-trading book exposures in equities held by the Group primarily arise within Commercial Banking Division from individual transactions in the private equity market and as a result of debt for equity swaps. These are generally medium term investments, held for gain and include limited partnership stakes 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.

The accounting techniques and valuation methodologies applied are set out within the Group's accounting policies, references to which are provided below.

- Available-for-sale financial assets, Note 2 (Accounting policies), Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 215 to 216
- Equity investments (including venture capital), Note 53 (Financial instruments), Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report and Accounts, page 317

A reference to the Group's accounting policies in relation to the recognition of impairment losses on available-for-sale financial assets is provided on page 46.

The balance sheet value of non-trading book exposures in equities, as at 31 December 2013, is presented in the table below. There was no difference between the balance sheet value and the fair value of these exposures.

Table 62: **Analysis of non-trading book exposures in equities**

Equity Grouping	2013 Balance Sheet Value £m	2012 Balance Sheet Value £m
Publicly quoted equities	111	94
Privately held equities	1,058	988
Total	**1,169**	1,082

Realised gains recognised in the year to 31 December 2013 in respect of the sale and liquidation of non-trading book exposures in equities amounted to £28m (2012: £387m).

As at 31 December 2013, net unrealised gains on available-for-sale equity investments amounted to £135m (2012: £56m). This gain has been included within tier 2 capital.

NON-TRADING BOOK SECURITISATIONS

The Group is an active participant in the securitisation market, operating as an originator, a sponsor of asset backed commercial paper conduits and as an arranger of and an investor in third party securitisations. The Group also provides liquidity and funding facilities to both own originated and sponsored securitisations as well as to third parties.

Securitisation Strategy and Roles

The Group undertakes securitisation activities for a number of reasons, including to manage risk concentrations in its balance sheet, to support relationships with customers and to manage its funding requirements and capital position.

As an originator the Group makes use of securitisation as a means of actively managing its balance sheet. Origination activities mainly extend around the Group's retail and commercial lending portfolios where the primary objective is funding, although certain synthetic commercial loan securitisations, involving the use of credit default swaps, are used for capital efficiency purposes. Further details on the Group's originated securitisations are provided on pages 80 to 84.

As a sponsor the Group manages and supports, through the provision of liquidity facilities, three asset backed commercial paper conduits (Cancara, Argento and Grampian). The Group closed both the Argento and Grampian conduit programmes in 2012 and continues to run down the remaining assets held by the respective purchasing vehicles.

As an investor the Group invests directly in third party asset backed securities and provides liquidity facilities to other third party securitisations.

Summary Analysis

As at 31 December 2013, credit risk exposures classed as securitisation positions amounted to £13.9bn (2012: £19.8bn). 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 securitisation positions that have been deducted from capital.

Table 63: **Summary of non-trading book securitisation exposures and capital requirements**

Securitisation type and risk weight approach	2013 Credit Risk Exposure [1] £m	2013 Risk Weighted Assets [2] £m	2013 Capital Requirement £m	2013 Deduction from Capital [3] [5] £m
Originated:				
Ratings Based Approach	600	63	5	13
Sponsored and Invested:				
Internal Assessment Approach	6,051	563	45	-
Ratings Based Approach	7,209	2,693	216	55
TOTAL [4]	13,860	3,319	266	68

Securitisation type and risk weight approach	2012 Credit Risk Exposure [1] £m	2012 Risk Weighted Assets [2] £m	2012 Capital Requirement £m	2012 Deduction from Capital [3] £m
Originated:				
Ratings Based Approach	5,594	2,636	211	150
Sponsored and Invested:				
Internal Assessment Approach	5,782	625	50	-
Ratings Based Approach	8,471	3,426	274	216
TOTAL [4]	19,847	6,687	535	366

Notes

[1] Credit risk exposure is defined as the aggregate of the Group's gross retained or purchased positions, excluding those positions rated below BB- or that are unrated and therefore deducted from capital.

[2] Risk weighted assets are stated net of value adjustments, where applicable. These adjustments represent a combination of impairment writedowns, acquisition related fair value adjustments and other fair value adjustments.

[3] Retained or purchased positions rated below BB- or that are unrated are deducted from capital. The amount deducted is stated net of value adjustments, as defined above.

[4] Excludes counterparty credit risk securitisation positions, further information on which can be found on page 102.

[5] An additional £74m (2012: nil) of positions relating to counterparty credit risk securitisation positions were deducted from capital.

ORIGINATED SECURITISATIONS

Overview of Originated Securitisation Structures

Traditional originated securitisation transactions typically involve the sale of a group or portfolio of ring fenced loans to another entity, referred to as a structured entity ('SE'). An SE 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 SE. The Group does, however, administer the SE and the originating Group company receives fees from the SE 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 SE group of companies. Interest and principal received from the underlying assets is used to fund the payment of the loan note interest and principal. Any residual income after paying the interest and principal on the notes and any fees and other operating costs is generally retained within the structure as additional reserve funds or distributed to the originating entity.

Notes issued are divided into separate tranches depending upon their level of subordination. Typically there will be senior, mezzanine and junior notes. In its most basic form, if a shortfall in income were to exist there would be no recourse to the originator. The shortfall would firstly be borne by any reserve funds within the structure and would then be borne as losses by the noteholders in the order of their subordination. In this way the most senior notes can achieve a high credit rating.

Investors who subscribe for the notes have the advantage of choosing the tranche that best meets their risk / return needs. In funding driven transactions, often the most junior tranches are retained by the Group so that there is effectively no significant risk transfer of credit risk away from the Group. Instead the vehicle serves as a diverse source of funding for the securitised assets.

Where there is deemed to be a significant transfer of risk then the Group benefits from lower regulatory capital requirements in respect of the securitised assets.

A synthetic securitisation transaction works in a similar way to the traditional version discussed above, except that the legal ownership of the underlying assets remains with the bank and the economic risk of the assets is transferred instead using credit default swaps. In certain cases the Group will retain the risk on the senior tranches.

Re-securitisation transactions undertaken by the Group involve securitisations where the risk associated with the underlying pool of assets is tranched and at least one of the underlying assets is a securitisation position. As at 31 December 2013 the Group had no remaining originated re-securitisation positions.

Summary of Accounting Policies

From an accounting perspective, the treatment of SEs is assessed in accordance with International Financial Reporting Standard ('IFRS') 10 which establishes the principles for when the Group is deemed to control another entity and therefore required to consolidate it through the Group's financial statements.

Under IFRS 10, the Group controls an entity where it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power.

Where the transfer of Group assets to an SE fails the 'derecognition' accounting tests under International Accounting Standard ('IAS') 39, a deemed loan is reflected in both the Group and SE 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 or partial sale where derecognition is achieved. The difference between the carrying amount and the consideration received is recorded in the income statement. Securitisation transactions that do not achieve derecognition are treated as financings.

The Group's securitised residential mortgage assets are not derecognised because the Group retains substantially all the risks and rewards associated with the underlying portfolios of assets. 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.

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.

Liquidity lines provided to the conduits are accounted for in accordance with the accounting policies set out in the 2013 Lloyds Banking Group plc Annual Report and Accounts.

- The Group's retained and purchased securitisation and re-securitisation positions are valued for accounting purposes in accordance with the Group's accounting policies as outlined on pages 214 to 216 (Financial Assets and Liabilities) of the 2013 Lloyds Banking Group plc Annual Report and Accounts.
- For those positions measured at fair value, further details on the valuation methodologies applied are outlined on pages 314 to 323 (Fair Value Measurement) of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

Securitisation Programmes and Activity

On an accounting basis, the Group's principal originated securitisation programmes, together with the balances of the advances subject to securitisation and the carrying value of the notes in issue at 31 December, are noted in the table below.

Table 64: **Securitisation programmes**

Securitisation Programmes [1]	**2013 Gross Assets Securitised £m**	2012 Gross Assets Securitised £m	Movement £m	**2013 Notes in Issue £m**	2012 Notes in Issue £m	Movement £m
UK residential mortgages	**55,998**	80,125	(24,127)	**36,286**	57,285	(20,999)
US residential mortgage backed securities	**-**	185	(185)	**-**	221	(221)
Commercial loans	**10,931**	15,024	(4,093)	**11,259**	14,110	(2,851)
Irish residential mortgages	**-**	5,189	(5,189)	**-**	3,509	(3,509)
Credit card receivables	**6,314**	6,974	(660)	**3,992**	3,794	198
Dutch residential mortgages	**4,381**	4,547	(166)	**4,508**	4,682	(174)
Personal loans	**2,729**	4,412	(1,683)	**750**	2,000	(1,250)
PFI / PPP and project finance loans	**525**	688	(163)	**106**	104	2
Motor vehicle loans	**-**	1,039	(1,039)	**-**	1,086	(1,086)
	80,878	118,183	(37,305)	**56,901**	86,791	(29,890)
Less notes held by the Group				**(38,288)**	(58,732)	
Total				**18,613**	28,059	

Notes

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

Gross assets securitised reduced by £37.3bn during the year, reflecting the closure of UK residential mortgage programmes, the Irish residential mortgage programme, commercial loans programmes and the Australian motor vehicle loans programmes. The reduction in gross assets securitised in relation to personal loans of £1.7bn reflects a combination of customer repayments and the non-replenishment of the pool over the period.

During the year the Group disposed of its holding in a portfolio of re-securitised US Residential Mortgage Backed Securities ('US RMBS').

No securitisation transactions undertaken during the year were recognised as sales (2012: nil).

Risks Inherent in Securitised Assets

The Group's securitisation programmes extend primarily around residential mortgage portfolios, credit card portfolios and commercial loan portfolios. In each case credit risk is the primary risk driver attached to the underlying asset pool. Assets securitised are predominantly originated from the Group's UK operations, other than for the Group's Dutch residential mortgage securitisation programmes and various assets within the Group's commercial securitisations, including certain PFI / PPP portfolios which are internationally diverse.

The performance of the securitised assets is largely dependent on prevailing economic conditions, and in the case of residential mortgage assets, the health of the housing market. The likelihood of defaults in the underlying asset pool and the amounts that may be recovered in the event of default are related to a number of factors and may vary according to characteristics, product type, security, collateral and customer support initiatives. Significant changes in the national or international economic climate, regional economic or housing conditions, changes in tax laws, interest rates, inflation, the availability of financing, yields on alternative investments, political developments and government policies or in the health of a particular geographic zone that represents a concentration in the securitised assets, could also affect the cashflows from the underlying asset pool.

Liquidity risk arises where insufficient funds are received by the SE to service payments to the noteholders as they fall due. The receipt of funds is in part dependent on the level of repayment on the underlying asset pool. In general, where such a situation arises noteholders may not be paid in full and amounts may be deferred to subsequent periods. Such deferred amounts will be due but not payable until funds become available in accordance with the relevant priority of payments as set out in the programme documentation. Variations in the rate of prepayment of principal on the underlying loans may affect each series and class of notes differently.

In addition, both the notes in issue and the underlying asset pool are exposed to interest rate risk and, in certain cases, may be subject to foreign exchange risk.

Where the Group holds notes in a securitisation it is exposed to the credit performance of the underlying asset pool, the impact of interest rate and, in some cases, foreign exchange volatility on the value of the notes, and to the seniority of the notes held, the latter of which determines the extent to which the Group would suffer any loss as a result of a shortfall in funds received by the SE.

Liquidity risk in the context of the Cancara conduit programme is covered in more detail on page 86.

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 positions in the securitisations are included within regulatory calculations rather than the underlying assets. Where the minimum requirements for recognition of significant risk transfer are not met, the underlying assets remain part of the relevant exposure class and are risk weighted accordingly. This mainly applies in the case of funding transactions.

Capital requirements in relation to originated securitisation positions are determined under one of the relevant IRB Approach methodologies or under the Standardised Approach. Where appropriate, the Group utilises the ratings services of several ECAIs ('External Credit Assessment Institutions'), being Standard & Poor's, Moody's and Fitch, to rate securitisation transactions and retained or purchased positions for risk weight allocation purposes.

Gross Securitised Exposure

On a regulatory basis, the gross securitised exposures in relation to originated securitisations where significant risk transfer has been achieved amounted to £0.9bn (2012: £8.9bn) comprising synthetic originated securitisations. An analysis is provided in the table below together with the amount of impaired exposures, past due but not impaired exposures and value adjustments.

Table 65: **Analysis of gross securitised exposures on a regulatory basis**

	Gross Securitised Exposure				
	2013 Traditional £m	**2013 Synthetic £m**	**2013 Impaired Exposures £m**	**2013 Past Due but not Impaired Exposures £m**	**2013 Value Adjustments £m**
Commercial, PFI / PPP and project finance loans	-	945	45	-	14
Re-securitisations	-	-	-	-	-
Total	-	945	45	-	14

	Gross Securitised Exposure				
	2012 Traditional £m	2012 Synthetic £m	2012 Impaired Exposures £m	2012 Past Due but not Impaired Exposures £m	2012 Value Adjustments [1] £m
Commercial, PFI / PPP and project finance loans	-	3,125	170	17	24
Re-securitisations	5,772	-	-	-	2,435
Total	5,772	3,125	170	17	2,459

Notes

[1] Value adjustments applied to re-securitisation exposures refer to impairment write downs, acquisition related fair value adjustments and other fair value adjustments. At 31 December 2012, £1,934m of these value adjustments applied against re-securitisation positions rated below BB- or that were unrated. The Group held no equivalent re-securitisation positions at 31 December 2013.

Key Movements

- Gross securitised exposures reduced by £8.0bn during the year, primarily reflecting the closure of a commercial loans synthetic securitisation programme and the disposal of the Group’s remaining retained positions in a portfolio of re-securitised US Residential Mortgage Backed Securities which resulted in a pre tax gain on sale of £538m.

The net charge to the income statement for the year to 31 December 2013 in respect of losses attributed to the gross securitised exposures noted above amounted to £2m (2012: £33m).

Monitoring Changes in the Credit Risk of Securitised Exposures

The Group employs a range of measures to monitor changes in the credit risk of securitised commercial, PFI / PPP and project finance loans. These include monitoring on a monthly basis of current exposures in the underlying pool (including credit events, default history and disposals), together with data tracking collateral cover and loan repayments which are tracked from the original amount advanced.

Use of Credit Default Swaps

The Group uses credit default swaps to securitise, in combination with external funding, commercial, PFI / PPP and project finance loans. The credit default swaps offer a level of credit protection to the Group over the positions retained in the synthetic securitisation programmes. The major swap counterparties include other institutions.

The Group's synthetic securitisations are legacy programmes and were established as synthetics, involving the use of credit default swaps, to reduce set up costs and to adopt a more simplified structure.

Assets Awaiting Securitisation

In 2012 the Group established a warehousing facility for a third party client with facility commitments amounting to £200m. As at 31 December 2013, £14m of the facility had been drawn down.

The Group is currently participating in the UK Government Help to Buy Scheme. Under this scheme HM Treasury guarantee to cover a proportion of any loss made by the lender arising from a higher loan-to-value mortgage being made. In accordance with the regulatory treatment proposed by the PRA, the benefit of the scheme will require a securitisation treatment and it is therefore anticipated that amounts extended under this scheme will be securitised. As at 31 December 2013, £79m had been extended under the scheme. Further details on the scheme are provided on page 305 of the 2013 Lloyds Banking Group plc Annual Report & Accounts.

Originated Securitisations Subject to the Ratings Based Approach

The Ratings Based Approach utilises a set of defined risk weights prescribed by the PRA. The appropriate risk weight is dependent on the rating of the position, its classification as a securitisation position or a re-securitisation position, the maturity and the seniority of the position and the granularity of the asset pool backing the position. As at 31 December 2013, securitisation and re-securitisation positions arising from origination activities and risk weighted under the Ratings Based Approach amounted to £0.6bn (2012: £7.7bn), generating a capital requirement of £5m (2012: £211m). An analysis of these positions, by risk weight category, is provided in the table below.

Table 66: **Analysis of originated positions by risk weight category**

S&P Equivalent Rating and RBA Risk Weight [1]		Securitisation Positions 2013						Re-securitisation Positions 2013				TOTAL 2013		TOTAL 2012	
		Senior		Non-Senior		Tranches Backed by Non Granular Pools		Senior		Non-Senior					
		Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req
AAA	(7%, 12%, 20%, 20%, 30%)	191	1	-	-	-	-	-	-	-	-	191	1	981	13
AA	(8%, 15%, 25%, 25%, 40%)	342	2	38	1	-	-	-	-	-	-	380	3	2,944	43
A+	(10%, 18%, 35%, 35%, 50%)	-	-	-	-	-	-	-	-	-	-	-	-	264	10
A	(12%, 20%, 35%, 40%, 65%)	-	-	24	-	-	-	-	-	-	-	24	-	249	13
A-	(20%, 35%, 35%, 60%, 100%)	-	-	-	-	-	-	-	-	-	-	-	-	184	16
BBB+	(35%, 50%, 50%, 100%, 150%)	-	-	-	-	-	-	-	-	-	-	-	-	90	11
BBB	(60%, 75%, 75%, 150%, 225%)	-	-	4	-	-	-	-	-	-	-	4	-	165	24
BBB-	(100%, 100%, 100%, 200%, 350%)	-	-	-	-	-	-	-	-	-	-	-	-	121	22
BB+	(250%, 250%, 250%, 300%, 500%)	-	-	-	-	-	-	-	-	-	-	-	-	218	59
BB	(425%, 425%, 425%, 500%, 650%)	-	-	1	1	-	-	-	-	-	-	1	1	178	
BB-	(650%, 650%, 650%, 750%, 850%)	-	-	-	-	-	-	-	-	-	-	-	-	190	-
Below BB- or unrated	Deduction	-	-	27	-	-	-	-	-	-	-	27	-	2,117	-
Total		533	3	94	2	-	-	-	-	-	-	627	5	7,701	211
Value adjustments taken to reserves [2]												(14)	-	(1,957)	-
Deduction from capital												(13)	-	(150)	-
Total Credit Risk Exposure / Cap Req [3]												600	5	5,594	211

Notes

[1] The Ratings Based Approach risk weights for each rating are listed in the following order: senior securitisation positions, non-senior securitisation positions, tranches backed by non-granular pools, senior re-securitisation positions and non-senior re-securitisation positions. Positions rated below BB- or that are unrated are deducted from capital, net of value adjustments applied.

[2] Value adjustments taken to reserves refer to impairment writedowns, acquisition related fair value adjustments and other fair value adjustments applied against gross positions rated below BB- or that are unrated. The net result is deducted from capital.

[3] Total credit risk exposure is defined as the aggregate of the Group's gross retained or purchased positions, excluding those positions rated below BB- or that are unrated and therefore deducted from capital. Capital requirements are stated net of value adjustments, where applicable. All retained positions are held on-balance sheet.

SPONSORED AND INVESTED SECURITISATIONS

The Group sponsors three asset backed commercial paper (‘ABCP’) conduits (Cancara, Argento and Grampian) that invest in debt securities and client receivables. The conduit structures consist of a series of bankruptcy remote SEs that purchase receivables or asset backed securities and are funded either by the issue of asset backed commercial paper or through the provision of liquidity and repo facilities. The structures generate fee income and net interest income for the Group.

During the course of 2012 the Group closed both the Argento and Grampian conduit programmes. As at 31 December 2013 no commercial paper remained in issuance in connection to either conduit and the remaining assets in the respective purchasing vehicles, which continue to be run down, are entirely funded by the Group.

Further details on Cancara are provided in the table below.

Cancara

General description	Cancara was established in 2002 by Lloyds Bank. It provides financing facilities to the Group’s core corporate and financial institution clients, funded by asset backed commercial paper.
Programme limit / CP outstanding as at 31 December 2013	$20.0bn / $8.3bn (£12.1bn / £5.0bn)
Conduit structure	Fully supported multi-seller
Credit enhancement	Programme wide letter of credit and full support liquidity
Liquidity provider	Lloyds Banking Group

All the external assets in the conduits are consolidated for accounting purposes in the Group's financial statements, following similar accounting policies to those established for originated securitisations. The total consolidated assets in the conduits are set out in the table below.

Table 67: **Conduit assets**

	2013 Cancara £m	**2013 Argento £m**	**2013 Grampian £m**	**2013 TOTAL £m**
Loans and advances	**4,781**	**161**	**9**	**4,951**
Debt securities classified as loans and receivables: Asset backed securities	**300**	**299**	**-**	**599**
Debt securities classified as available-for-sale financial assets: Asset backed securities	**-**	**356**	**-**	**356**
Total assets	**5,081**	**816**	**9**	**5,906**

	2012 Cancara £m	2012 Argento £m	2012 Grampian £m	2012 TOTAL £m
Loans and advances	4,342	140	58	4,540
Debt securities classified as loans and receivables: Asset backed securities	367	603	358	1,328
Debt securities classified as available-for-sale financial assets: Asset backed securities	-	396	143	539
Total assets	4,709	1,139	559	6,407

Total consolidated assets reduced by £501m during the year, primarily as a result of the disposal of further assets from the Argento and Grampian conduit programmes, following their closure in 2012.

Cancara

Structure and liquidity facilities

Cancara Asset Securitisation Limited is an asset backed commercial paper conduit that buys assets from clients of the Group via advances made to various purchasing companies. The conduit funds the purchase of the assets primarily by issuing ABCP. Cancara Asset Securitisation LLC is a separate bankruptcy remote, special purpose limited liability company established to co-issue US Dollar domestic commercial paper from Cancara Asset Securitisation Limited.

Assets purchased relate to pools of third party receivables.

There are a number of intermediary special purpose entities within the conduit structure that are used to purchase the assets. Each purchasing company enters into a purchasing agreement with the issuer, which then advances funds to the purchasing company to buy the assets. The purchasing company issues a purchaser demand note to the issuer which benefits from security over the assets.

The Group provides support to the programme in its roles as sponsor, administrator and liquidity / programme wide credit enhancement provider.

For each new asset purchase, Cancara enters into a liquidity facility with the Group. The liquidity is used to cover any mismatch between available income and any shortfall in repaying the ABCP notes. In the absence of market disruption the conduit will usually look to fund through issuing ABCP and therefore, in most circumstances, the liquidity facility should not require to be drawn down upon under normal circumstances. In March 2012 the conduit was converted from partial support to full support liquidity, covering repayment of issued ABCP in full.

At 31 December 2013, liquidity facilities provided by the Group to Cancara amounted to £6.1bn (2012: £5.8bn), none of which had been drawn down (2012: nil).

Capital assessment

For Cancara, the Group has approval to utilise the ABCP Internal Assessment Approach for calculating capital requirements for the liquidity facilities provided to the conduit purchasing companies.

The Group’s ABCP Internal Assessment Approach model is a proprietary credit rating system for rating liquidity facilities to entities that have been set up to issue asset backed commercial paper, such as Cancara.

Unlike the Group’s Foundation and Retail IRB models, the ABCP Internal Assessment Approach model does not estimate the probability of default for the exposure, but instead is used to determine a model rating grade equivalent to an ECAI (rating agency) grade, where the internal rating methodology must reflect the ECAI’s methodology. The equivalent ECAI rating is then assigned a risk weight percentage by mapping it to the relevant BIPRU Credit Quality Step (‘CQS’). The risk weight is then applied to the risk position in order to derive an RWA and ultimately the capital requirement. The model itself consists of a number of scorecards, one for each asset class.

It is a requirement under BIPRU 9.12.20 that the rating methodology used is aligned to the rating criteria published by ECAIs. Periodically, ECAIs publish updates to their methodologies relating to different asset classes. The Conduit Team monitors rating agency updates and undertakes regular reviews of the model to confirm that all relevant changes to rating methodologies have been reflected in the cashflow modelling and the ABCP Internal Asssessment Approach model.

Stress factor inputs play an important part in determining the rating of a transaction. Depending on the level of credit enhancement, the stress factor will determine the final rating a transaction would receive from an ECAI taking into account ‘stressed scenarios’ on the level of cash-flows generated by the underlying pool of assets.

Cancara receivables facilities are modelled using a stress factor input which reflects the ability of the transaction to withstand a deterioration in the asset quality and is a Through-the-Cycle measure that is applied to a base case default rate. To determine the base case default rate historic loss data is used. For example, in its approach S&P incorporates additional analysis into historic loss data to mitigate any effects of recent changes with the result that in many cases the base case loss rate assumed is above the historical average.

The model is subject to a robust governance framework. In line with the Rating Model Validation Framework, the Group undertakes an Annual Credit Rating Model Validation exercise to ensure that the model remains compliant with the requirements of BIPRU 9.12.20 which establishes the critieria that must be met in order to apply the ABCP Internal Assessment Approach to exposures relating to ABCP programmes such as liquidity facilities. A Risk Model Decision Forum ensures that re-approval of the model is conducted systematically, with appropriate peer challenge and review. Re-approval documentation is subject to the internal model approval processes in place within the Group.

As at 31 December 2013, the total credit risk exposure of the Group in respect of the liquidity facilities provided to Cancara amounted to £6.1bn (2012: £5.8bn). An analysis of this exposure, by underlying exposure type, is provided in the table below.

Table 68: **Analysis of Cancara positions by exposure type**

Exposure Type	2013 Exposure £m	2012 Exposure £m
Mortgage Backed Securities:		
US RMBS	-	59
CMBS	29	28
Personal Sector:		
Auto loans	2,729	2,053
Credit cards	241	272
Trade receivables	1,115	1,245
Insurance premium funding loans	973	1,089
Capital calls	397	526
Other receivables [1]	567	510
Total Credit Risk Exposure	6,051	5,782

Notes

[1] Other receivables relate predominantly to dealer floorplan receivables and consumer finance.

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

Table 69: **Analysis of Cancara positions by risk weight category**

S&P Equivalent Rating and IAA Risk Weight	2013 Exposure £m	2013 Capital Req £m	2012 Exposure £m	2012 Capital Req £m
AAA: 7%	3,079	18	2,875	17
AA: 8%	1,089	8	1,108	8
A+: 10%	819	7	824	7
A: 12%	973	10	788	8
A-: 20%	62	1	63	1
BBB+: 35%	-	-	-	-
BBB: 60%	29	1	29	1
BBB-: 100%	-	-	95	8
Total Credit Risk Exposure / Capital Requirement	6,051	45	5,782	50

Argento and Grampian

Following the closure of both the Argento and Grampian conduit programmes, the remaining assets in the conduit purchasing companies are being funded by the Group through a combination of liquidity facilities and repurchase facilities.

For both Argento and Grampian, capital requirements are assessed by looking through to the underlying asset portfolios held. As a result the liquidity and repurchase facilities do not attract capital. Risk positions attached to the underlying asset portfolios are treated in a similar way to risk positions arising from invested securitisation activities, with capital requirements calculated under the Ratings Based Approach.

Direct Investments and Liquidity Facilities

In addition to sponsoring asset backed commercial paper conduits, the Group invests directly in third party asset backed securities and is a provider of liquidity facilities to other third party securitisations. Investments in asset backed securities are primarily used as part of the Group's liquidity asset portfolio.

The majority of these direct 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 held at fair value through profit and loss. Further details on the Group’s holding of asset backed securities are presented on pages 332 to 335 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

Monitoring Changes in the Credit Risk of Asset Backed Securities Portfolios

The monitoring of changes in the credit risk of asset backed securities portfolios is undertaken by the Structured Credit Investment (‘SCI’) team. Credit reviews are produced at least annually for a particular sector or for a specific bond (or both) as well as for third party ABS liquidity facilities. A credit review process will also be triggered where an ECAI applies a significant downgrade to a bond.

The Securitised Assets Credit team provide an independent risk oversight of the SCI credit reviews by providing each ABS transaction with a Credit Risk Classification (ranging from Good Book to Substandard), as well as sanctioning credit limits either locally or by referral to the Credit Committee.

Additional risk measures covering the ABS portfolios include: monthly Watch List meetings (which include a review of downgraded bonds), quarterly preparation of IAS 39 reports and stress testing of portfolios and a quarterly Portfolio Risk Review Forum ('PRRF') between Risk Division representatives and the business teams.

Similar processes are used to monitor changes in credit risk associated with re-securitisation positions.

Analysis of Argento, Grampian, Direct Investment and Liquidity Facility Credit Risk Exposures

As at 31 December 2013, the total credit risk exposure arising in respect of the risk positions attached to the underlying asset portfolios of Argento and Grampian, direct investments in third party asset backed securities and the provision of liquidity facilities to third party securitisations amounted to £7.2bn (2012: £8.5bn).

An analysis of these exposures, by exposure type, is provided in the table below.

Table 70: **Analysis of Argento, Grampian and other positions by exposure type**

Exposure Type	2013 Exposure £m	2012 Exposure £m
Mortgage Backed Securities:		
US RMBS	172	215
Non-US RMBS	2,417	2,997
CMBS	1,937	2,677
Collateralised Debt Obligations:		
CLO	1,681	2,040
Other	240	134
Personal Sector:		
Auto loans	557	301
Credit cards	-	188
Personal loans	8	56
FFELP Student Loans	308	151
Total	7,320	8,759
Value adjustments taken to reserves [1]	(56)	(72)
Deduction from capital	(55)	(216)
Total Credit Risk Exposure [2]	7,209	8,471

Notes

[1] Value adjustments taken to reserves refer to impairment writedowns, acquisition related fair value adjustments and other fair value adjustments applied against gross positions rated below BB- or that are unrated. The net result is deducted from capital.

[2] Total credit risk exposure is defined as the aggregate of the Group's gross retained or purchased positions, excluding those positions rated below BB- or that are unrated and therefore deducted from capital.

Key Movements

- Credit risk exposures reduced by £1.3bn during the year, primarily reflecting disposals and the non-replenishment of holdings after amortisations and maturities.

As at 31 December 2013, securitisation positions relating to the underlying asset portfolios of Argento and Grampian and securitisation and re-securitisation positions relating to the Group's direct investments in third party asset backed securities and the provision of liquidity facilities to third party securitisations, risk weighted under the Ratings Based Approach, amounted to £7.3bn (2012: £8.8bn), generating a capital requirement of £216m (2012: £274m). An analysis of these positions, by risk weight category, is provided in the table below.

Table 71: **Analysis of Argento, Grampian and other positions by risk weight category**

S&P Equivalent Rating and RBA Risk Weight [1]		Securitisation Positions 2013						Re-securitisation Positions 2013				TOTAL 2013		TOTAL 2012	
		Senior		Non-Senior		Tranches Backed by Non Granular Pools		Senior		Non-Senior					
		Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req	Exposure	Cap Req
AAA	(7%, 12%, 20%, 20%, 30%)	1,906	12	12	-	571	10	-	-	-	-	2,489	22	2,566	22
AA	(8%, 15%, 25%, 25%, 40%)	1,281	9	127	2	564	12	35	1	-	-	2,007	24	2,487	31
A+	(10%, 18%, 35%, 35%, 50%)	-	-	-	-	266	8	-	-	-	-	266	8	612	7
A	(12%, 20%, 35%, 40%, 65%)	106	1	15	-	385	11	-	-	-	-	506	12	833	15
A-	(20%, 35%, 35%, 60%, 100%)	281	5	-	-	354	11	132	6	-	-	767	22	426	12
BBB+	(35%, 50%, 50%, 100%, 150%)	-	-	-	-	46	2	-	-	-	-	46	2	269	4
BBB	(60%, 75%, 75%, 150%, 225%)	263	12	20	1	215	14	-	-	-	-	498	27	517	30
BBB-	(100%, 100%, 100%, 200%, 350%)	322	17	-	-	61	3	-	-	-	-	383	20	254	16
BB+	(250%, 250%, 250%, 300%, 500%)	49	10	-	-	14	3	-	-	-	-	63	13	311	59
BB	(425%, 425%, 425%, 500%, 650%)	103	37	47	17	34	12	-	-	-	-	184	66	118	41
BB-	(650%, 650%, 650%, 750%, 850%)	-	-	-	-	-	-	-	-	-	-	-	-	78	37
Below BB- or unrated	Deduction	23	-	-	-	53	-	-	-	35	-	111	-	288	-
Total		4,334	103	221	20	2,563	86	167	7	35	-	7,320	216	8,759	274
Value adjustments taken to reserves [2]												(56)	-	(72)	-
Deduction from capital												(55)	-	(216)	-
Total Credit Risk Exposure / Cap Req [3]												7,209	216	8,471	274

Notes

[1] The Ratings Based Approach risk weights for each rating are listed in the following order: senior securitisation positions, non-senior securitisation positions, tranches backed by non-granular pools, senior re-securitisation positions and non-senior re-securitisation positions. Positions rated below BB- or that are unrated are deducted from capital, net of value adjustments applied.

[2] Value adjustments taken to reserves refer to impairment writedowns, acquisition related fair value adjustments and other fair value adjustments applied against gross positions rated below BB- or that are unrated. The net result is deducted from capital.

[3] Total credit risk exposure is defined as the aggregate of the Group's gross retained or purchased positions, excluding those positions rated below BB- or that are unrated and therefore deducted from capital. Capital requirements are stated net of value adjustments, where applicable.

Re-securitisation Positions

The underlying securitisation positions in connection to the re-securitisation positions held by the Group relate to senior positions in CLO transactions and commercial real estate CDO transactions.

Provision of Liquidity Facilities to Third Parties

Of the gross exposure amount of £7,320m noted above, exposures amounting to £2,471m (2012: £2,656m) relate to the Group's provision of liquidity facilities to third party securitisations.

TRADING BOOK SECURITISATIONS

At 31 December 2013 the Group held a small portfolio of non-correlation trading book securitisation positions amounting to £185.8m (2012: £154.6m) with an associated market risk capital requirement of £11.3m (2012: £1.7m).

Trading Book Securitisation Strategy and Roles

The Group's trading book securitisation portfolio consists primarily of investments in third party securitisation positions. No re-securitisation positions were held at year end through the trading book (2012: nil).

The Group currently has a single London based Asset Backed Securities Trading desk, the main objectives of which are as follows:

- to create a secondary market through normal market making activity for Group related issuance where the underlying loans or receivables are originated by the Group;
- to support the development of a third party securitisation debt capital market business that generates fees for the Group by normal market making activities; and
- to carry out normal market making activities in support of Group clients.

The Trading desk does not undertake origination activities and does not structure transactions, nor does it re-structure or re-securitise securitisations for the purposes of holding them on the trading book.

Inherent Risks

The key risks attached to the Group's holding of trading book securitisation positions are noted below:

- Price Risk: Systemic and non-systemic risk arising from the fluctuations in securities prices. This includes factors such as interest rates and currency prices.
- Credit Risk: The borrower's inability to meet interest payment obligations on time. Default may occur when maintenance obligations on the underlying collateral are not sufficiently met as detailed in its prospectus. A key indicator of a particular security's default risk is its credit rating. Different tranches within the Group's asset backed securities portfolio are rated differently, with senior classes of most issues receiving the highest rating, and subordinated classes receiving correspondingly lower credit ratings.
- Event Risk: The majority of asset backed securities are subject to some degree of early amortisation or pre-payment risk. The risk stems from specific early amortisation events or payout events that cause the security to be paid off prematurely.
- Interest Rate Fluctuations: The prices of ABS move in response to changes in interest rates. Furthermore, interest rate changes may affect the prepayment rates on underlying loans that back some types of asset backed securities, which can affect yields.
- Moral Hazard: Investors usually rely on the deal manager to price the securitisations' underlying assets. If the manager earns fees based on performance; there may be a temptation to mark up the prices of the portfolio assets. Conflicts of interest can also arise with senior note holders when the manager has a claim on the deal's excess spread.
- Servicer Risk: The transfer or collection of payments may be delayed or reduced if the servicer becomes insolvent. This risk is mitigated by having a backup servicer involved in the transaction.

As the Group's trading book securitisation portfolio is relatively small and highly liquid, with positions held for the short-term, liquidity risk is considered to be of minimal concern.

Monitoring Changes in Credit and Market Risk

The Group's policy is to invest in highly rated securitised bonds, typically carrying ratings of AA or better. Risk management of the Asset Backed Security Trading Book is shared between Credit Risk and Market Risk teams. Under Credit Risk, monitoring positions are subject to notional limits and also maximum holding periods; notional limits are by credit rating and there are also asset class restrictions. Market Risk monitors foreign exchange, interest rate and credit spread risk daily through the VaR models.

In the event of a breach of the maximum holding period the Group will conduct a review of the underlying assets relating to the positions held to assess their creditworthiness and a strict process put in place for managing or reducing the exposure.

Hedging and Unfunded Credit Protection

The policy for hedging exposures within the trading book is governed by the VaR Framework. This establishes trading book risk limits, as well as a requirement to hedge against foreign exchange risk and interest rate risk.

The Asset Backed Securities Trading desk in Lloyds Banking Group does not use unfunded credit protection that directly references any of its holding of trading desk securitisation positions. Therefore, on that basis, the Asset Backed Securities Trading desk does not specifically hedge any of its funded or cash positions.

Risk Weight Approach and ECAIs Used

The market risk capital requirement associated with the Group's holding of trading book securitisation positions represents the specific interest rate risk of securitisation positions held in the trading book and is determined in accordance with the transitional requirements under BIPRU 7.2.48A, being the higher of the capital charges applied to the net long positions or to the net short positions.

Position Risk Adjustments ('PRAs') under the 'IRB Approach' are applied to the relevant positions in order to determine the specific interest rate risk capital charge. ECAI ratings are used to assign positions to the relevant credit quality step under the Specific Risk PRA – IRB Approach scale. Ratings are based upon the assessments of a least two major ECAIs (e.g. Standard & Poor's, Moody's or Fitch Ratings).

Accounting Policies

The Group recognises its trading book securitisation positions at fair value through profit or loss. The positions are treated as sales (market making) with gains or losses recognised on a daily basis as the price of the underlying bonds change. Valuations are determined by reference to an independent, third party consensus pricing service.

At year end there were no assets awaiting securitisation in the Group's trading book (2012: nil).

All trading book securitisation positions are on balance sheet.

Summary of Activity

The Group's portfolio of trading book securitisation positions is relatively small and therefore not significant in the context of the overall trading book. The portfolio is likely to remain of a similar size going forward.

Exposures Securitised by the Group

The Group does not securitise any of its own exposures via the trading book.

Analysis of Trading Book Securitisation Positions

The following table analyses the Group's exposure to retained or purchased non-correlation trading book securitisation positions and associated capital requirement by rating grade.

Table 72: **Analysis of trading book securitisation positions by risk weight category**

S&P Equivalent Rating and Specific Risk PRA (IRB) [1]		Non-Correlation Trading Book Securitisation Positions							
		Senior 2013		Non-Senior 2013		TOTAL 2013		TOTAL 2012	
		Exp £m[2]	Cap Req £m[3]	Exp £m[2]	Cap Req £m[3]	Exp £m[2]	Cap Req £m[3]	Exp £m[2]	Cap Req £m[3]
AAA	(0.56%, 0.96%)	106.1	0.6	1.5	-	107.6	0.6	124.7	0.7
AA	(0.64%, 1.20%)	34.5	0.2	-	-	34.5	0.2	13.6	0.1
A+	(0.80%, 1.44%)	-	-	-	-	-	-	0.2	-
A	(0.96%, 1.60%)	2.0	-	-	-	2.0	-	0.9	-
A-	(1.60%, 2.80%)	2.0	-	0.1	-	2.1	-	0.5	-
BBB+	(2.80%, 4.00%)	4.0	0.1	3.3	0.1	7.3	0.2	1.5	-
BBB	(4.80%, 6.00%)	0.7	-	-	-	0.7	-	5.0	0.3
BBB-	(8.00%, 8.00%)	10.8	0.9	-	-	10.8	0.9	8.2	0.6
BB+	(20.00%, 20.00%)	1.1	0.2	-	-	1.1	0.2	-	-
BB	(34.00%, 34.00%)	3.0	1.0	0.3	0.1	3.3	1.1	-	-
BB-	(52.00%, 52.00%)	14.0	7.3	-	-	14.0	7.3	-	-
Unrated	(100.00%, 100.00%)	-	-	2.4	0.8	2.4	0.8	-	-
Total		178.2	10.3	7.6	1.0	185.8	11.3	154.6	1.7

Notes

[1] The specific risk PRAs (IRB Approach) for each rating are listed in the following order: senior positions then non-senior positions.

[2] The exposure amount is determined by the market value of the individual net positions.

[3] The capital requirement represents the specific interest rate risk of securitisation positions held in the trading book and is determined in accordance with the transitional requirement under BIPRU 7.2.48A, being the higher of the capital charges applied to net long positions or to net short positions.

The following tables analyses the Group's exposure to retained or purchased non-correlation trading book securitisation positions and associated capital requirement by underlying exposure type.

Table 73: **Analysis of trading book securitisation positions by exposure type**

Exposure Type	2013 Exposure £m	2013 Capital Requirement £m	2012 Exposure £m	2012 Capital Requirement £m
RMBS	68.2	7.6	134.6	0.7
CMBS	16.9	1.6	2.8	-
Credit cards	7.7	-	-	-
Loans to corporates	1.1	-	8.2	0.7
Trade receivables	0.2	-	5.7	0.3
Leasing	44.4	0.3	-	-
Other	47.3	1.8	3.3	-
Total	**185.8**	**11.3**	154.6	1.7

CREDIT RISK MITIGATION

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

INTERNAL CONTROL

Credit principles and policy: Risk Division sets out the credit principles and policy according to which credit risk is managed. Principles and policies are reviewed regularly, and any changes are subject to a review and approval process. Policies, where appropriate, are supported by lending guidelines, which also define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions. These policies and lending guidelines define chosen target market and risk acceptance criteria. Risk Division also use early warning indicators to help anticipate future areas of concern and allow the Group to take early and proactive mitigating actions. Risk 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. Oversight and reviews are also undertaken by Group Audit and Credit Risk Assurance.

Controls over rating systems: The Group has established an independent team in the Risk Division that sets common minimum standards, designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements. Internal rating systems are developed and owned by the Risk Division. Line management takes responsibility for ensuring the validation of the rating systems, supported and challenged by an independent specialist group function.

Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite as well as individual limit guidelines. Credit policy is aligned to the Group's risk appetite and restricts exposure to higher risk countries and more vulnerable sectors and segments. Exposures are monitored to prevent an excessive concentration of risk and single name concentrations. 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 certain minimum policy and/or guideline requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.

Cross-border exposures: The Board sets country risk appetite. Within this, country limits are authorised by the country limits committee, taking into account economic, financial, political and social factors. Group policies stipulate that these limits must be consistent with, and support, the approved business and strategic plans of the Group.

Specialist expertise: Credit quality is managed and controlled by a number of specialist units within Risk Division providing, for example: intensive management and control (see Intensive care of customers in financial difficulty); 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.

Stress testing and scenario analysis: The Group's credit portfolios are also subjected to regular stress testing, with stress scenario assessments run at various levels of the organisation from Group led exercises to individual divisions / portfolios exercises. For further information on the stress testing process, methodology and governance refer to pages 127 to 128 of the 2013 Lloyds Banking Group plc Annual Report & Accounts.

Credit risk assurance and review: A specialist team within Group Audit, comprising experienced credit professionals, is in place to perform credit risk assurance. This team carries out independent risk based internal control audits and credit quality reviews, providing an assessment of the effectiveness of internal controls, risk management practices, credit risk classification, as well as the accuracy of impairment provisions. These audits and reviews cover the diverse range of the Group's businesses and activities, and include both 'standard' risk based audits and reviews as well as bespoke assignments to respond to any emerging risks or regulatory requirement. The work of Group Audit therefore continues to provide executive and senior management (and Audit Committee) with assurance and guidance on credit quality, effectiveness of credit risk controls and Business Support Unit (BSU) work out strategies, as well as accuracy of impairments.

Credit risk assurance within Commercial Banking is also undertaken by Commercial Risk Assurance. Commercial Risk Assurance is an independent credit risk oversight function operating within Commercial Banking Risk, part of the Group's second line of defence, while Group Audit performs third line of defence assurance.

Additional Mitigation for Retail Customers (lending to individuals in Retail and Wealth, Asset Finance and International divisions)

The Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by credit reference agencies (CRA). The Group also assesses the affordability of the borrower under stressed scenarios including increased interest rates. In addition, the Group has in place quantitative limits such as product maximum limits, the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application.

The Group also has certain criteria that are applicable to specific products such as for applications for a mortgage on a property that is to be let by the applicant.

The Group's lending practices within Retail have changed since 2009 in several ways: the Group has lowered its maximum loan-to-value (LTV) thresholds, which have been reduced across all mortgage product types; the Group has withdrawn from 'specialist' secured lending since early 2009 (self-certificated and sub-prime lending) and increased credit scorecard cut-offs for both secured and unsecured lending; and the Group has tightened its assessments and the maximum limit for affordability of borrowings for both secured and unsecured lending. In addition, the number of properties permitted in buy-to-let portfolios has been reduced.

For UK mortgages, the Group's policy is to reject all standard applications with a LTV greater than 90 per cent. Applications with a LTV up to 95 per cent are permitted for certain schemes, for example Help to Buy and Lend a Hand. For mainstream mortgages the Group has maximum per cent LTV limits which depend upon the loan size. These limits are currently:

Table 74: **Loan to value analysis**

Loan size		
From	**To**	**Maximum LTV**
£1	£600,000	95%
£600,001	£750,000	90%
£750,001	£1,000,000	85%
£1,000,001	£2,000,000	80%
£2,000,001	£5,000,000	70%

For mainstream mortgages greater than £5,000,000 the maximum LTV is 50 per cent. Buy-to-let mortgages are limited to a maximum of £1,000,000 and 75 per cent LTV. All mortgage applications above £500,000 are subject to manual underwriting.

The Group's approach to underwriting applications for unsecured products in Retail takes into account the total unsecured debt held by a customer and their affordability. The Group rejects any application for an unsecured product where a customer is registered as bankrupt or insolvent, or has a County Court Judgment registered at a CRA used by the Group. In addition, for credit cards the Group rejects any applicant with total unsecured debt greater than £50,000 registered at the CRA; revolving debt-to-income ratio greater than 75 per cent; or total unsecured debt-to-income ratio greater than 100 per cent. For unsecured personal loan applications, the Group rejects any applicant with total unsecured debt greater than £50,000 registered at the CRA. Rules around refinancing of debt have also been made more stringent since 2009 as a result of the application of rules relating to the total unsecured debt held by a customer and the Group's approach in assessing affordability. This has resulted in fewer customers being eligible to refinance unsecured debt.

Credit scoring: In its principal retail portfolios, the Group uses statistically based decisioning techniques (primarily credit scoring models). The Risk Division reviews model effectiveness, while new models and model changes are referred by them to the appropriate Model Governance Committees for approval. The most material changes are approved in accordance with the governance framework set by the Group Model Governance Committee.

Additional Mitigation for Commercial Customers

Individual credit assessment and independent sanction: With the exception of low exposure on SME customers where relationship managers have some limited delegated sanctioning authority, credit risk in commercial customer 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 and limit guidelines. Approval requirements for each decision are based on a number of factors including 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 is generally the same as that for assets intended to be held over the period to maturity.

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.

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.

COLLATERAL

The principal collateral types for loans and advances, contingent liabilities and derivatives with commercial counterparties / customers are:

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

The Group maintains appetite 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 bills are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, 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. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement.

It is the Group's policy that collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral is reviewed on a regular basis and will vary according to the type of lending and collateral involved. For residential mortgages, the Group adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of the collateral. 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 appropriate and likely to be effective, the Group seeks to enter into master netting agreements. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, 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 this is the net position of all trades under the master netting agreement.

GUARANTEES

A guarantee is a contract whereby a third party guarantor promises to recompense the lender in the event of failure by a customer to meet their obligations. Regulatory capital relief is only taken through the use of PD substitution for guarantees provided by appropriate central governments, central banks or institutions. Where regulatory capital relief is sought to reflect the risk mitigating effect of a guarantee, there are minimum operational and legal requirements which are required to be met. On the basis that these are met, alternative forms of protection, for example indemnities, may be classified as a guarantee for regulatory capital purposes.

EXPORT CREDIT AGENCIES

These agencies are defined as state or government sponsored, owned or controlled organisations or multi-lateral agencies that promote a country's exports of goods and services by enabling the exporter or the importer to obtain financing on terms that would not be otherwise available commercially. Such agencies can provide risk mitigation in the form of a guarantee (typically up to 85% - 95% of a contract value) providing cover and guarantee of payment in relation to commercial and political risk, thereby enabling lenders to support customers by offering financing on terms and for periods which might otherwise not be available in certain jurisdictions.

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. Capital relief under regulatory requirements is restricted to the following types of credit derivative: Credit Default Swaps; Total Return Swaps; and Credit Linked Notes (to the extent of their cash funding).

In respect of a Credit Default Swap, various credit events defined in the International Swap Dealers Association ISDA (including bankruptcy, failure to pay and restructuring) affecting the obligor, can trigger settlement. Settlement usually takes place by the protection buyer being paid by the protection seller the notional amount minus the recovery as determined by an auction of the eligible securities of the obligor governed by ISDA.

Under a Total Return Swap, the protection buyer will pass on to the seller all payments it receives in return for an interest related payment (market rate and spread), plus any decrease in the market value of the credit obligation. Where net payments received from the swap are recorded as net income but any offsetting deterioration in the value of the asset that is protected is not recorded (either through reductions in fair value or by an addition to reserves), the credit protection must not be recognised as eligible.

Under a Credit Linked Note, the protection buyer will issue a bond or note which is linked to the creditworthiness of an obligor and backed by certain collateral. The bond or note is purchased by the protection seller and the investor will receive a coupon on the bond or note (market rate and spread). If a credit event occurs in either the obligor or the collateral, the bond or note is redeemed by the protection buyer with the recovery being the redemption amount. If no credit event occurs, the bond or note will be redeemed at par by the protection buyer.

OTHER CREDIT RISK TRANSFERS

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

EXPOSURES COVERED BY ELIGIBLE COLLATERAL, GUARANTEES AND CREDIT DERIVATIVES

Credit risk mitigation applied in regulatory capital calculations typically takes the form of one or more of the following:

- Eligible financial collateral
- Other eligible collateral
- Guarantees
- Credit derivatives

Only certain types of collateral are deemed eligible for regulatory capital purposes. Eligible financial collateral includes cash on deposit within the bank, gold, rated debt securities (subject to certain restrictions), equities or convertible bonds included in a main index and units in certain collective investment undertakings or mutual funds. Other eligible collateral includes forms of real estate collateral, short term financial receivables and other physical collateral (as specified through the Group's Foundation IRB waiver permission), provided the criteria for recognition are met.

The recognition of eligible collateral requires a number of factors to be considered including, legal certainty of charge, frequency and independency of revaluation and correlation of the value of the underlying asset to the obligor.

Application under the IRB Approach

Where a credit risk 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 or LGD value used in the calculation of the associated capital requirement.

In recognising eligible financial collateral under the Foundation IRB Approach, the Group adjusts the relevant LGD value in accordance with the application of the Financial Collateral Comprehensive Method ('FCCM'), applying adjustments for volatility and currency mismatch, in addition to maturity mismatches for all collateral types.

Other eligible collateral applied under the Foundation IRB Approach will typically result in an adjustment to the regulatory LGD value, subject to a floor of 35 per cent for senior debt and 65 per cent for subordinated debt. The adjustment applied is dependent on the value and type of collateral used.

Guarantees and credit derivatives are reflected through an adjustment to, or determination of, either the PD or LGD values.

Application under the Standardised Approach

Where a credit risk exposure subject to the Standardised Approach is covered by a form of eligible financial collateral the EAD value is adjusted accordingly under the Financial Collateral Comprehensive Method. Where guarantees or credit derivatives apply, the risk weight applied to the portion of the exposure covered by the protection provider is based on the risk weight attached to the provider. The covered portion is determined after the application of 'haircuts' for currency and maturity mismatch applied to the protection provided. The risk weight applied to the uncovered portion of the exposure is not impacted.

The use of credit derivatives and collateral in respect of securitisation positions and counterparty credit risk exposures respectively are discussed further within the Securitisations and Counterparty Credit Risk sections of the document on pages 79 to 93 and 101 to 105 respectively.

Analysis of Credit Risk Exposures Covered by Eligible Collateral, Guarantees and Credit Derivatives

The following table provides an analysis of Foundation IRB Approach, IRB Supervisory Slotting Approach and Standardised Approach credit risk exposures covered by eligible financial collateral, other eligible collateral, guarantees or credit derivatives.

The analysis excludes exposures covered by forms of credit risk mitigation that are not taken into consideration in the calculation of credit risk capital requirements.

The impact of the eligible financial collateral and guarantees on exposures risk weighted under the Standardised Approach is disclosed on pages 72 to 77.

Table 75: **Eligible collateral, guarantees and credit derivatives**

	2013 Exposures Covered by Eligible Financial Collateral £m	2013 Exposures Covered by Other Eligible Collateral £m	2013 Exposures Covered by Guarantees £m	2013 Exposures Covered by Credit Derivatives £m	2013 TOTAL £m
Exposures subject to the IRB Approach					
Foundation IRB Approach					
Corporate – Main	3,663	13,207	87	8	16,965
Corporate – SME	197	9,256	-	-	9,453
Corporate - Specialised lending	-	-	-	-	-
Central governments and central banks	-	-	334	-	334
Institutions	686	-	99	-	785
Other IRB Approach					
Corporate - Specialised lending	858	-	-	-	858
Total - IRB Approach	5,404	22,463	520	8	28,395
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	188	83	271
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	-	-	-	-
Multilateral development banks	-	-	-	-	-
Institutions	-	-	-	-	-
Corporates	1,269	-	-	-	1,269
Retail	-	-	-	-	-
Secured by mortgages on residential property	-	-	-	-	-
Secured by mortgages on commercial real estate	-	-	-	-	-
Past due items	5	-	-	-	5
Short term claims on institutions or corporates	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-
Total - Standardised Approach	1,274	-	188	83	1,545
TOTAL	6,678	22,463	708	91	29,940

Key Movements

- Foundation IRB Approach corporate exposures covered by other eligible collateral increased by £7.8bn during the year, primarily reflecting the recognition of additional social housing real estate collateral and commercial finance short term financial receivables.
- Standardised Approach exposures covered by eligible financial collateral reduced by £0.8bn during the year predominantly as a result of non-core portfolio disposals and the transitioning of portfolios to the IRB Approach.
- Guarantees covering exposures secured by mortgages on residential property under the Standardised Approach reduced from £443m to nil during the year following the roll-out of the BOS Netherlands IRB residential mortgage model. The guarantees are no longer recognised in the calculation of the related credit risk capital requirements.

❖ Further details on collateral held as security for financial assets, collateral pledged as security and collateral repossessed can be found in Note 54 (Financial risk management), Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 336 to 339.

	2012 Exposures Covered by Eligible Financial Collateral £m	2012 Exposures Covered by Other Eligible Collateral £m	2012 Exposures Covered by Guarantees £m	2012 Exposures Covered by Credit Derivatives £m	2012 TOTAL £m
Exposures subject to the IRB Approach					
Foundation IRB Approach					
Corporate - Main	4,185	9,374	620	91	14,270
Corporate - SME	284	5,131	-	-	5,415
Corporate - Specialised lending	25	122	-	-	147
Central governments and central banks	-	-	255	-	255
Institutions	289	-	326	91	706
Other IRB Approach					
Corporate - Specialised lending	862	-	-	-	862
Total - IRB Approach	5,645	14,627	1,201	182	21,655
Exposures subject to the Standardised Approach					
Central governments and central banks	1	-	-	-	1
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	-	-	-	-
Multilateral development banks	-	-	-	-	-
Institutions	-	-	-	-	-
Corporates	1,908	-	42	-	1,950
Retail	64	-	-	-	64
Secured by mortgages on residential property	-	-	443	-	443
Secured by mortgages on commercial real estate	9	-	-	-	9
Past due items	52	-	2	-	54
Short term claims on institutions or corporates	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-
Total - Standardised Approach	2,034	-	487	-	2,521
TOTAL	7,679	14,627	1,688	182	24,176

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 obligor ratings equivalent to investment grade as measured by external credit rating agencies.

Internal obligor ratings are mapped to modelled 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.

Additionally a number of product specific, obligor quality limit guidelines and counterparty specific policies also serve to determine risk management and credit limit setting. Once commercial approval has been obtained for a counterparty, credit limits are established through the Group's credit approval framework on the basis of the projected maximum potential future exposure of anticipated derivative transaction volumes, based on 95th percentile assumptions.

Credit limits are set by product and reflect documentation held for netting or collateral management purposes. Outstanding exposures are calculated on a potential future exposure basis, based upon the transaction characteristics and documentation.

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. For certain derivative transactions which meet eligibility for clearing at a Central Counterparty ('CCP'), counterparty credit risk is replaced by an exposure against the CCP.

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). It is policy that appropriate documentation is put in place for all clients prior to trading, any exceptions being subject to specific approval from the appropriate Credit Sanctioner. Policy also defines minimum acceptable requirements for the negotiation of ISDA and CSA documentation.

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 (WRONG WAY) 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. Countries with a rating equivalent to AA- and above are considered to have no adverse correlation between the counterparty domiciled in the country and that country of risk (issuer of securities).

COLLATERAL REQUIREMENTS IN THE EVENT OF A DOWNGRADE IN CREDIT RATING

Internal stress testing results at 31 December show that the Group has liquidity resources representing 130.9 per cent of modelled outflows from all wholesale funding sources, retail and corporate deposits, intra-day requirements and rating dependent contracts under the Group's most severe liquidity stress scenario (the three month PRA combined scenario).

The Group's stress testing assumes that further credit rating downgrades may reduce investor appetite for some of the Group's liability classes and therefore funding capacity. A hypothetical idiosyncratic two notch downgrade of the Group's current long-term debt rating and accompanying short-term downgrade implemented instantaneously by all major rating agencies, could result in an outflow of £6.6bn of cash over a period of up to one year, £3.0bn of collateral posting related to customer financial contracts and £11.8bn of collateral posting associated with secured funding. The Group's internal liquidity risk appetite includes such a stress scenario. The stress scenario modelling demonstrates the Group has available liquidity resources to manage such an event.

DERIVATIVE VALUATION ADJUSTMENTS

Details on the application of derivative valuation adjustments, including Credit and Debit Valuation Adjustments (CVA and DVA), are provided in the Group's Annual Report and Accounts as referenced below.

❖ Derivative valuation adjustments, Note 53 (Financial instruments), Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report and Accounts, pages 322 to 323.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY MEASUREMENT APPROACH

The credit risk exposure value in respect of counterparty credit risk as at 31 December 2013 was £21.3bn (2012: £26.3bn). An analysis by measurement approach is presented in the table below.

Table 76: **CCR: analysis by measurement approach**

	2013 Credit Risk Exposure [1] £m	2012 Credit Risk Exposure [1] £m
CCR Standardised Approach	**-**	-
CCR Mark to Market Method	**21,345**	26,339
CCR Internal Model Method	**-**	-
	21,345	26,339

Notes

[1] Counterparty credit risk exposures are stated on an EAD post CRM basis throughout this section.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY EXPOSURE CLASS

An analysis of counterparty credit risk exposures as at 31 December 2013, by exposure class, is presented in the table below.

Table 77: **CCR: analysis by exposure class**

	2013 Credit Risk Exposure £m	2012 Credit Risk Exposure £m
Foundation IRB Approach		
Central governments and central banks	**515**	457
Institutions	**7,602**	7,389
Corporates	**5,037**	6,449
Other IRB Approach		
Corporate – Specialised lending [1]	**3,673**	-
Securitisation positions [2]	**185**	171
Standardised Approach		
Central governments and central banks	**3,355**	5,513
Institutions	**303**	165
Corporates	**664**	6,195
Other	**11**	-
Total	**21,345**	26,339

Notes

[1] Exposures subject to the IRB Supervisory Slotting Approach.

[2] Securitisation positions include £74m of net exposure deducted from capital. The credit risk exposure value of the positions prior to the application of value adjustments amounted to £132m.

Key Movements

- Counterparty credit risk exposures reduced by £5.0bn over the year, primarily as a result of mark-to-market movements, portfolio compression, movement to central clearing and other management actions.
- The significant reduction in Standardised corporates, from £6.2bn to £0.7bn, was primarily the result of the transfer of portfolios to IRB Approach models. This included the transfer of corporate specialised lending portfolios to the IRB Supervisory Slotting Approach.
- Counterparty credit risk RWAs, as presented in Table 79 on page 103, reduced from £12.8bn to £7.8bn, reflecting both the reduction in exposures and the transfer of Standardised corporates portfolios to the IRB Approach.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY CONTRACT TYPE

An analysis of counterparty credit risk exposures as at 31 December 2013, by contract type, is presented in the table below.

Table 78: **CCR: analysis by contract type**

	2013 Credit Risk Exposure £m	2012 Credit Risk Exposure £m
Interest rate and inflation contracts	11,733	16,582
Foreign exchange contracts	2,111	1,580
Equity contracts	471	378
Credit derivatives	313	228
Commodity contracts	17	74
Securities financing transactions	6,700	7,497
Other	-	-
Total	21,345	26,339

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY RISK WEIGHT APPROACH

An analysis of counterparty credit risk exposures and RWAs as at 31 December 2013, by risk weight approach, is presented in the table below.

Table 79: **CCR: analysis by risk weight approach**

	2013 Credit Risk Exposure £m	2013 Risk Weighted Assets £m	2012 Credit Risk Exposure £m	2012 Risk Weighted Assets £m
Foundation and Other IRB Approaches	17,012	7,082	14,466	6,162
Standardised Approach	4,333	712	11,873	6,686
Total	21,345	7,794	26,339	12,848

COUNTERPARTY CREDIT RISK EXPOSURES: FURTHER ANALYSIS OF IRB EXPOSURES

Further analysis, by PD Grade, of counterparty credit risk exposures subject to the Foundation IRB Approach and the IRB Supervisory Slotting Approach are provided in the tables below.

CCR - Central Governments and Central Banks

Table 80: **CCR central government and central bank exposures by PD grade**

PD Grade	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	434	0.02%	2.37%	230	0.02%	2.45%
5	-	-	-	-	-	-
6	4	0.07%	14.18%	218	0.05%	6.51%
7	3	0.11%	13.19%	8	0.11%	14.62%
8	74	0.17%	19.54%	-	-	-
9	-	-	-	-	-	-
10	-	-	-	-	-	-
11	-	-	-	-	-	-
12	-	-	-	-	-	-
13	-	-	-	1	1.87%	99.16%
14	-	-	-	-	-	-
15	-	-	-	-	-	-
16	-	-	-	-	-	-
17	-	-	-	-	-	-
18	-	-	-	-	-	-
19	-	-	-	-	-	-
20 – 23 (Default)	-	-	-	-	-	-
Total	515	0.05%	5.07%	457	0.04%	4.43%

CCR - Institutions

Table 81: **CCR institution exposures by PD grade**

PD Grade	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	1,788	0.03%	13.79%	3,293	0.03%	9.25%
5	2,501	0.04%	15.64%	1,398	0.04%	19.00%
6	2,218	0.06%	20.29%	1,490	0.06%	21.77%
7	597	0.11%	32.51%	487	0.11%	32.24%
8	66	0.18%	41.70%	89	0.18%	37.95%
9	253	0.28%	49.03%	213	0.28%	49.47%
10	125	0.45%	64.46%	72	0.45%	61.17%
11	21	0.75%	86.83%	308	0.75%	89.33%
12	14	1.01%	78.53%	4	1.00%	76.55%
13	1	1.62%	99.32%	16	1.62%	105.36%
14	6	2.39%	117.42%	7	2.10%	106.92%
15	1	4.50%	159.15%	4	3.91%	130.73%
16	-	-	-	-	-	-
17	3	8.00%	196.81%	-	-	-
18	-	-	-	-	-	-
19	8	31.00%	285.34%	8	56.90%	220.39%
20 – 23 (Default)	-	-	-	-	-	-
Total	7,602	0.11%	20.80%	7,389	0.15%	21.70%

CCR - Corporates

Table 82: **CCR corporate exposures by PD grade**

PD Grade	2013 Credit Risk Exposure £m	2013 Exposure Weighted Average PD %	2013 Average Risk Weight %	2012 Credit Risk Exposure £m	2012 Exposure Weighted Average PD %	2012 Average Risk Weight %
1 - 4	1,065	0.03%	22.69%	992	0.03%	19.98%
5	164	0.05%	12.57%	451	0.04%	20.99%
6	540	0.07%	20.96%	218	0.06%	15.86%
7	563	0.11%	39.67%	544	0.11%	22.40%
8	435	0.17%	48.98%	336	0.18%	24.66%
9	677	0.27%	53.11%	952	0.28%	35.66%
10	579	0.42%	62.63%	1,136	0.42%	52.56%
11	222	0.68%	90.09%	516	0.64%	59.80%
12	182	1.07%	104.19%	377	1.00%	69.37%
13	111	1.70%	117.69%	268	1.61%	84.13%
14	87	2.70%	132.31%	149	2.58%	99.32%
15	6	3.87%	164.65%	94	4.19%	112.52%
16	33	5.58%	164.39%	38	5.80%	145.33%
17	20	8.70%	224.82%	26	8.70%	147.78%
18	33	13.08%	242.27%	52	10.73%	208.90%
19	86	30.45%	274.39%	122	56.90%	216.76%
20 – 23 (Default)	234	100.00%	-	178	100.00%	-
Total	5,037	5.62%	51.53%	6,449	4.64%	70.13%

CCR – Corporates (Supervisory Slotting)

Table 83: **CCR corporate exposures subject to supervisory slotting**

	Remaining Maturity <2.5 years		Remaining Maturity >2.5 years	
Grade	**2013 Exposure £m**	**2013 Risk Weighted Assets £m**	**2013 Exposure £m**	**2013 Risk Weighted Assets £m**
1) Strong	123	77	1,530	1,071
2) Good	59	50	739	664
3) Satisfactory	12	14	339	390
4) Weak	21	52	220	551
5) Default [1]	81	-	549	-
Total	296	193	3,377	2,676

Notes

[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.

NET DERIVATIVES CREDIT EXPOSURE

The gross positive fair value of contracts, netting benefits, netted current credit exposure, net potential future credit exposure ('PFE'), collateral held and resultant 'net derivatives credit exposure', as at 31 December 2013, are presented separately in the table below.

Table 84: **Net derivatives credit exposure**

	2013 £m	2012 £m
Gross positive fair value of contracts	48,726	70,028
Netting benefits	(38,758)	(54,010)
Netted current credit exposure	9,968	16,018
Net potential future credit exposure	7,042	10,669
Collateral held [1]	(2,365)	(7,845)
Total Net Derivatives Credit Exposure	14,645	18,842
Securities financing transactions	6,700	7,497
Total Counterparty Credit Risk Exposure [2]	21,345	26,339

Notes

[1] Collateral held primarily relates to cash and government securities.

[2] Total counterparty credit risk exposures relate to trades that are not settled through central counterparties. Exposures settled through central counterparties included in the netted current credit exposure are revised down to an EAD value of nil, in accordance with regulatory requirements, through an adjustment applied to the net potential future credit exposure and do not therefore form part of the total counterparty credit risk exposure value.

❖ An analysis of derivative notional balances, indicating amounts traded on recognised exchanges and amounts traded over the counter (further sub-analysed by those settled by central counterparties and those not settled by central counterparties) is provided on page 143 of the 2013 Lloyds Banking Group plc Annual Report and Accounts..

NOTIONAL VALUE OF CREDIT DERIVATIVE TRANSACTIONS

The notional value of credit derivative transactions outstanding at 31 December 2013 was £8.9bn (2012: £5.7bn), an analysis of which is presented in the table below. These transactions relate to credit default swaps and total return swaps.

Table 85: **Notional value of credit derivative transactions**

	2013 Notional Value £m	2012 Notional Value £m
Own credit portfolio – protection bought [1]	3,476	2,403
Own credit portfolio – protection sold [2]	5,442	3,329
Total	8,918	5,732

Notes

[1] Own credit portfolio (protection bought) comprises £3,331m (2012: £2,403m) of credit default swaps and £145m (2012: nil) of total return swaps.

[2] Own credit portfolio (protection sold) comprises £2,654m (2012: £1,944m) of credit default swaps and £2,788m (2012: £1,385m) of total return swaps.

MARKET RISK

DEFINITION

Market risk is defined as the risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and bond prices, foreign exchange rates, equity, property and commodity prices and other instruments), lead to changes in earnings and / or value.

RISK APPETITE

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 cascaded to an appropriate level within their areas of responsibility.

EXPOSURES

Trading Portfolios

The Group's trading activity is small relative to its peers and the Group does not have a programme of proprietary trading activities. All the trading Value-at-Risk ('VaR') resides within Commercial Banking. The average 95 per cent 1-day trading VaR was £4.1m for the year to 31 December 2013 (2012: £7.0m). The Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange, credit spread and interest rate products.

Trading market risk measures are applied to all the Group's regulatory trading books where positions arise from supporting customer flow and market making. All positions are held with trading intent. Measures include daily VaR (table 89, page 110), sensitivity based measures, and stress testing. The Group's trading book assets and liabilities are substantially originated by Financial Markets within the Commercial Banking Division. Within the Group's balance sheet these fall under the trading assets and liabilities and derivative financial instruments. Refer to the table below.

Table 86: **Market risk linkages to the balance sheet for trading portfolios and Banking activity items**

31 December 2013	Balance Sheet Total £m	Trading Books £m	Relevant Notes from Financial Statements [1] £m
Assets			
Trading and other financial assets at fair value through profit or loss	142,683	42,376	Note 17
Derivative financial instruments	33,125	25,531	Note 18
Loans and advances to customers	495,281	-	Note 20
Liabilities			
Trading and other financial liabilities at fair value through profit or loss	43,625	38,319	Note 34
Derivative financial instruments	30,464	25,086	Note 18
Customer deposits	441,311	-	Note 33

Notes

[1] Notes to the Consolidated Financial Statements, 2013 Lloyds Banking Group plc Annual Report & Accounts

The table above shows relevant balance sheet items relating to banking and trading activities. The trading book VaR sensitivity inputs are separately identified.

Banking Activities

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 or liability.

Interest rate risk in the Group's divisional portfolios and in the Group's capital and funding activities arises from the different repricing characteristics of the Group's non-trading assets, liabilities (see loans and advances to customers and customer deposits per the table above) and off balance sheet positions of the Group. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, but also to the investment term of capital and reserves, and the need to minimise income volatility.

Margin compression risk also arises from the current low rate environment, which may restrict the ability to change interest rates applying to customers in response to changes in interbank and central bank rates.

Prepayment risk arises, predominantly in the Retail division, as customer balances amortise more quickly or slowly than anticipated due to economic conditions or customer's response to changes in economic conditions.

Pipeline and pre hedge risk arises where new business volumes are higher or lower than forecasted, requiring the business to unwind or execute additional hedging at rates which may differ to what was expected.

Basis risk also arises from the possible changes in spreads, for example where the bank lends with reference to a central bank rate but funds with reference to LIBOR and the spread between these widens or tightens.

Foreign currency risk also arises from:

(a) translational exposure: the Group's investment in its overseas operations. Net investment exposures are disclosed (see page 112) and it is Group policy to hedge non-functional currency exposures; and

(b) transactional exposure: where assets and liabilities are denominated in currencies other than the business' functional currency. The Group has a policy of forward hedging its forecasted currency income less impairments to year end.

Table 87: **Key market risks for the Group (PBT impact measured against Group single stress scenarios)**

	Risk Type					
	Interest Rate	Basis Risk	FX	Credit Spread	Equity	Inflation
Defined benefit pension schemes	●		●	●	●	●
Trading portfolios	●	●	●	●		●
Banking activities	●	●	●	●	●	●
Insurance portfolios	●		●	●	●	●
Profit before tax:						
>£500m	●					
£250m to £500m	●					
<£250m	●					
<£50m	●					

MEASUREMENT

Market risk is managed within a Board approved framework and risk appetite. This is supplemented by divisional market risk appetite limits and triggers. A variety of risk measures are used such as:

- Scenario / stress based measures (e.g. single factor stresses, macroeconomic scenarios).
- Percentile based measures (e.g. VaR and Stressed VaR); and
- Sensitivity based measures (e.g. sensitivity to 1 basis point move in interest rates);

Scenario based measures include the use of five different economic multi-risk scenarios which the Group introduced as part of its Board risk appetite. These assess the impact of unlikely, but plausible adverse scenarios on income, with the worst case for defined benefit pensions, trading portfolios, banking activities and insurance portfolios being reported against the Board risk appetite.

Internal market risk models for trading book activities comprise VaR, Stressed VaR and Incremental Risk Charge.

Although an important market standard measure of risk, VaR has limitations. These arise from the use of limited historical data, an assumed distribution, defined holding periods, set confidence intervals and frequency of calculation. The exposure level at the confidence interval does not convey any information about potential losses which may arise if this level is exceeded. A 95 per cent confidence interval with a 1-day holding period is equivalent to an expected 1 in 20 day loss. The Group recognises these limitations and supplements the use of VaR with a variety of other techniques more suited to the nature of the business activity.

In addition:

- Capital impact and deficit triggers are used in respect of defined benefit pensions which have a material impact on capital resources.
- Profit and loss triggers are used in the trading books in order to ensure that mitigating action is considered if profit and loss becomes volatile.
- Interest rate repricing gaps, earnings sensitivity analysis, and open foreign exchange positions are used for banking book activity, and
- Stress testing and scenario analysis are also used in certain portfolios and at Group level, to simulate the impact of extreme conditions and to understand more fully the interdependence of different parts of the balance sheet.

These measures are reviewed regularly by senior management to inform effective decision making.

The Group's VaR Model permissions allow it to calculate Pillar 1 market risk capital requirements for the trading book using internal models. The LBG Model permission covers general interest rate and foreign exchange risk across both Lloyds Bank and HBOS portfolios. The capital charge is based on the 10-day 99 per cent VaR and Stressed VaR calculated by the models. The Stressed VaR is the measure of VaR using a continuous one year window based on a period of market stress. In addition the model permission covers specific interest rate risk and the capital charge incorporates specific interest rate risk through VaR and Stressed VaR. This is complemented by an Incremental Risk Charge ('IRC') for the trading book.

The Group uses an historical simulation methodology to calculate VaR for the trading book. This methodology consists of calculating historical daily price movements for 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 same VaR model is applied across all portfolios. A 1-day 95th percentile VaR is used for internal management purposes, and the 10-day 99th percentile VaR and Stressed VaR is applied for regulatory capital calculation for the Group's trading book positions which are calculated under the Internal Models Approach. The VaR and Stressed VaR are also integrated into the risk management process for efficient capital management and to highlight potentially significant exposures based on previous market volatility.

The Group's trading book stress testing programme 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 which would not be captured within VaR, 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.

Stressed VaR uses historical market data from a continuous one year period of significant financial stress which is relevant to the trading book positions. The one year dataset is taken from any period since the beginning of 2007 and therefore potentially include the market movements experienced during the financial crisis. Stressed VaR is calibrated at least quarterly to the period of stress which generates the highest Stressed VaR with the current exposures in the Group's trading books.

The IRC measures the risks arising from both default and loss inducing rating migrations in the trading book. The charge is computed over a one year capital horizon with the 99.9th percentile worst loss taken as the value of the charge. A Monte Carlo approach is used to simulate the profit and loss changes arising from migration and default for each portfolio position in turn. The profit and loss changes from each position contribute to the overall loss distribution. The calculation uses a multi-factor Gaussian Copula model. A one year liquidity horizon is applied for all positions within this portfolio.

Validation of the risk models uses a number of methods including but not limited to stress tests, sensitivity analyses and scenarios analyses. The model is reviewed independently of the development team and model adequacy and conservatism is re-assessed over time should the portfolio change over time. Model performance, including backtesting analysis, is regularly reviewed by the Model Governance Committee.

Key Characteristics of Market Risk Models

Component Modelled	Significant Models and Associated Capital Requirement	Model Description and Methodology	Model Updates / Validation	Number of Days of Market Data	Applicable Regulatory Thresholds for the Industry
VaR	1Model; (£56m)	Historical simulation to create a distribution of potential daily P&Ls from market moves	Credit Spread VaR and Foreign Exchange VaR component of the model last reviewed and approved for another year by Model Governance Committee in April 2013. Interest rate VaR component of the model last reviewed and approved for another year by Model Governance Committee in December 2013.	300 daily P&Ls	Regulatory VaR is computed with 10 day holding period and 99% confidence level
SVaR	1Model: (£240m)	Same as VaR model	Model last reviewed and approved for another year by Model Governance Committee in December 2013	365 day period of significant stress, updated quarterly	Regulatory SVaR is computed with 10 day holding period and 99% confidence level
IRC	1Model: (£106m)	Monte Carlo approach is used to simulate the profit and loss changes arising from rating migration and default	Model last reviewed and approved for another year by Model Governance Committee in December 2013	Does not rely on historical data	IRC is computed with a 1 year holding period and 99.9% confidence level

Backtesting of VaR Models

The Group compares a hypothetical daily profit and loss with VaR calculated at a 1-day 99 per cent 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 the individual trading desk level. 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 PRA categorises a VaR model as green, amber or red in accordance with the number of exceptions observed over the back testing period. A backtesting exception is generated when a loss is greater than the 1-day 99 per cent VaR for a given day. The Group's trading books maintained their green model status in 2013.

Each individual entity is required to have sufficient capital to meet their solo capital requirements. Hence VaR model performance monitoring needs to be performed separately across Lloyds Bank and HBOS heritage portfolios. The Group manages its market risk at a consolidated basis and this is reflected in a single CRD III Market Risk waiver permission. Hence backtesting is also done at a consolidated basis to monitor VaR model performance at a consolidated Group level. Below the entity level there is backtesting performed at business area level. The number of exceptions in these portfolios at business area level do not necessarily add up to the number of exceptions in the consolidated portfolio.

Charts comparing VaR to the hypothetical profit and loss on a daily basis, at both entity level and by business area, are provided on pages 114 to 115.

Table 88: **Backtesting results (VaR models)**

2013 Backtesting Results	Zone [1]	Number of reported exceptions
Entity Level		
Lloyds Bank	Green	0
HBOS	Green	2
LBG	Green	1
Major Business Area		
Rates Product	Green	1
FX Product	Green	0
Credit Product	Green	0
Capital and Collateral Management	Green	0

Note

[1] Green = four exceptions or below; Amber = five to nine exceptions; Red = ten exceptions or more

Analysis

- Statistically the Group would expect to see losses in excess of VaR 1 per cent of the time over a one-year period and the zone categories reflect this expectation. The VaR models have remained well within the green zone at both entity and business area levels. The Group expects exceptions to occur on average 1 per cent of the time and hence over 2013 has considered that no action is required to rectify or adapt its VaR models.

- All four backtesting exceptions in 2013 occured on two days, 20 and 24 June, when there were significant GBP interest rate movements following the US Federal Reserve's indications on future bond purchases a few days earlier.

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.

❖ Full details on the use of valuation models and related adjustments are provided in Note 53 (Financial instruments), Notes to the Consolidated Financial Statements, of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

The main valuation adjustments are summarised below:

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

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

- The Group's derivative trading business applies valuation adjustments against the changing market approach to valuing derivatives that are subject to daily collateral margin, where standard market practice is to pay interest on an Overnight Index Swap basis rather than a LIBOR rate.

- The carrying amount of issued notes that are designated at fair value through profit and loss is adjusted to reflect the effect of changes in own credit spreads. The resulting gain or loss is recognised in the income statement.

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. The key elements of the control framework for the valuation of financial instruments include model validation, product implementation review and independent price verification. Where models are used, the assumptions, methodologies, mathematics and software implementation are assessed and challenged by suitably qualified parties independent of the development process.

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

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 PRA in prudential returns.

Trading Portfolios

Based on the 1-day 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the years ended 31 December 2013 and 2012 based on the Group's global trading positions are detailed in the table below.

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 five risk types. 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 trading book positions arising from short term market facing activity.

The average VaR for 2013 was lower than the average over 2012 due primarily to lower credit spread and interest rate exposure and improvement in market conditions. Trading book VaR assumes no diversification across risk type, instead it is a simple sum of interest rate, foreign exchange, credit spread, and inflation risk.

Table 89: **Trading portfolios: VaR 1-day 95 per cent confidence level**

VaR Measures	**2013 Close £m**	**2013 Average £m**	**2013 Maximum £m**	**2013 Minimum £m**
Interest rate risk	**3.5**	**2.9**	**4.8**	**2.0**
Foreign exchange risk	**0.2**	**0.4**	**2.0**	**0.1**
Equity risk	**-**	**-**	**-**	**-**
Credit spread risk	**0.8**	**0.5**	**1.4**	**0.3**
Inflation risk	**0.2**	**0.3**	**0.7**	**0.1**
Total VaR	**4.7**	**4.1**	**6.5**	**2.7**

VaR Measures	2012 Close £m	2012 Average £m	2012 Maximum £m	2012 Minimum £m
Interest rate risk	2.8	4.2	7.4	1.9
Foreign exchange risk	0.3	0.4	1.0	0.02
Equity risk	-	-	-	-
Credit spread risk	0.8	1.9	3.6	0.7
Inflation risk	0.5	0.5	1.3	0.1
Total VaR	4.4	7.0	11.4	4.1

The Group's Stressed VaR (based on a 10-day 99 per cent confidence level) and Incremental Risk Charge measures presented on a similar basis to the VaR measures above are detailed in the table below.

Table 90: **Trading portfolios: Stressed VaR 10-day 99 per cent confidence level and Incremental Risk Charge**

Stressed VaR / IRC Measures	2013 Close £m	2013 Average £m	2013 Maximum £m	2013 Minimum £m
Interest rate risk	28.5	41.0	134.2	9.2
Foreign exchange risk	15.5	9.3	26.9	1.0
Credit spread risk	22.6	10.3	24.1	3.2
Total Stressed VaR	66.6	60.6	157.7	29.9
Incremental Risk Charge	105.8	54.4	117.8	32.6

Stressed VaR / IRC Measures	2012 Close £m	2012 Average £m	2012 Maximum £m	2012 Minimum £m
Interest rate risk	45.5	61.6	125.7	24.9
Foreign exchange risk	17.8	8.7	21.8	0.1
Credit spread risk	12.2	11.0	27.4	5.4
Total Stressed VaR	75.5	81.3	155.1	45.0
Incremental Risk Charge	47.4	42.9	75.9	33.7

The maximum and minimum Stressed VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum Stressed VaR reported as a whole.

Open market risk for the trading operations continues to be low with respect to the size of the Group and similar institutions, reflecting the fact that the Group's trading operations are customer-centric, focusing on hedging and recycling client risks.

Market Risk Capital Requirement

As at 31 December 2013 the capital requirement in respect of market risk in the trading book amounted to £887m (2012: £912m).

Table 91: **Analysis of market risk capital requirement**

Approach / Risk	2013 Capital Requirement £m	2012 Capital Requirement £m
Internal Models Approach		
VaR [1]	77	119
Stressed VaR	240	280
Incremental Risk Charge	106	47
Standardised Approach		
Interest rate position risk requirement	125	138
Foreign currency position risk requirement	27	23
Equity position risk requirement	1	3
Commodity position risk requirement	-	-
Specific interest rate risk of securitisation positions [2]	11	2
	587	612
Temporary capital buffer [3]	300	300
Total	887	912

Notes:

[1] The VaR model capital charge includes £21m (2012: £31m) of additional capital charges calculated in respect of market risk factors captured under the Group's 'Risks not in VaR' framework.

[2] Further details on the calculation of the specific interest rate risk of securitisation positions is provided on page 92 under the Trading Book Securitisations section of the document.

[3] The temporary capital buffer is expected to be removed once specific market risk infrastructure projects have been completed.

The majority of the Group's trading book positions are assigned a capital requirement under the Internal Models Approach. Where positions in the Group's trading book are not currently included within internal model capital calculations, the market risk capital requirement for these positions is calculated using the PRA standard market risk rules. Market Risk capital has reduced during the period mainly due to a reduction in VaR and Stressed VaR as a result of reductions in exposure and improvement in market conditions. IRC capital has increased as a result of the extension of internal market risk model coverage. The specific interest rate risk from the Group's securitisation positions has increased due to increased exposure to low grade issuers held in the Asset Backed Securities Portfolio.

No positions within the Group's trading book are subject to the All Price Risk Measure.

Banking Activities

Market risk in non-trading books consists of exposure to changes in interest rates including basis risk. This is the potential impact on earnings and value that occurs due to mismatches in the timing of repricing assets and liabilities.

Interest rate risk exposure is monitored monthly using, primarily:

(a) Market value sensitivity: this methodology considers all repricing mismatches (behaviourally adjusted where appropriate) in the current balance sheet and calculates the change in market value that would result from an instantaneous 25, 100 and 200 basis points parallel rise or fall in the yield curve (subject to a floor at zero per cent).

(b) Interest income sensitivity: this measures the impact on future net interest income arising from an instantaneous 25, 100 and 200 basis points parallel rise or fall in the yield curves over a rolling 12 month basis (subject to a floor at zero per cent). Unlike the market value sensitivities, the interest income sensitivities incorporate additional behavioural assumptions as to how and when individual products would reprice in response to such change.

(c) Value at Risk (VaR): for short dated portfolios and other accrual accounted trading portfolios, where the portfolio turns over more than once within a three month horizon, VaR is used for internal risk management.

(d) Market Value notional limit: this caps the amount of conventional and inflation-linked government bonds held by the Group for liquidity purposes.

The Group has an integrated Asset and Liability Management (ALM) system which supports non traded asset and liability management of the Group. This provides a single consolidated tool to measure and manage interest rate repricing profiles (including behavioural assumptions), perform stress testing and produce forecast outputs. Interest rate gaps are reported by currency and used to calculate the income and value sensitivities (in GBP equivalent). Repricing assumptions and customer reaction to changes in product pricing is a major determinant of the risk profile. The Group is aware that any assumptions based model is open to challenge. However, a full behavioural review is performed annually by Group ALM functions to ensure the assumptions remain appropriate, and is reviewed by Risk Division.

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, the Group's market value sensitivities to an instantaneous parallel up and down 25 basis points change to all interest rates.

Table 92: **Banking activities: market value sensitivity**

	2013 Up 25bps £m	**2013 Down 25bps £m**	2012 Up 25bps £m	2012 Down 25bps £m
Sterling	**(25.1)**	**25.6**	104.9	(108.3)
US Dollar	**16.3**	**(16.5)**	14.9	(16.7)
Euro	**(0.4)**	**0.6**	14.5	(8.5)
Australian Dollar	**(0.7)**	**(0.1)**	1.0	(1.0)
Other	**(0.3)**	**0.3**	(0.1)	0.1
Total	**(10.2)**	**9.9**	135.2	(134.4)

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.

The following table shows the banking book income sensitivity to an instantaneous a parallel up and down 25 basis points change to all interest rates.

Table 93: **Banking activities: net interest income sensitivity**

	2013 Up 25bps £m	**2013 Down 25bps £m**	2012 Up 25bps £m	2012 Down 25bps £m
Client facing activity and associated hedges	**48.2**	**(136.0)**	202.0	(209.3)

The market value sensitivity is driven by temporary customer flow positions not yet hedged plus other positions occasionally held within limits, by the Group's wholesale funding desks in order to minimise overall funding and hedging costs. The level of risk is low relative to the size of the total balance sheet.

The fall in net interest income sensitivity reflects further structural hedging against margin compression undertaken in 2013, and a revision of the assumptions as to how variable retail savings would reprice in a rising rate scenario.

MITIGATION

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

Trading Portfolios and Banking Activities

The Group's policy is to optimise reward whilst managing its interest rate risk exposures within the risk appetite defined by the Board. For individual banking divisions, simple positional interest rate risk is minimal due to the Group requirement for these businesses to hedge (or match fund) promptly all open positions directly via the Group Corporate Treasury (GCT) function.

As defined within the scope of the Group IRRBB Policy, all hedgeable interest rate risk in the non-traded book should be transferred to GCT via the Interest Rate Risk Transfer Pricing (ITP) framework. GCT is responsible for managing centralised risk (both traded and non-traded) and does this through natural offsets of matching assets and liabilities, and appropriate hedging activity of the residual exposures, subject to the authorisation and mandate of Group Asset and Liability Committee within the Board Risk Appetite. Derivative desks in Financial Markets will then externalise the hedges to the market. However, certain residual interest rate risks may remain outside the centre due to differences in basis and profile mismatches, largely arising from customer behaviour.

Customer facing divisions incur foreign exchange risk in the course of providing services to their customers. GCT incurs foreign exchange risk through its various debt and capital management programmes. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled within the trading risk appetite and any residual risk is hedged in the market.

MONITORING

The Group Asset and Liability Committee and the Group Market Risk Committee regularly review high level market risk exposure, as part of the wider risk management framework. They also make 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 by Risk Division and where appropriate, escalation procedures are in place.

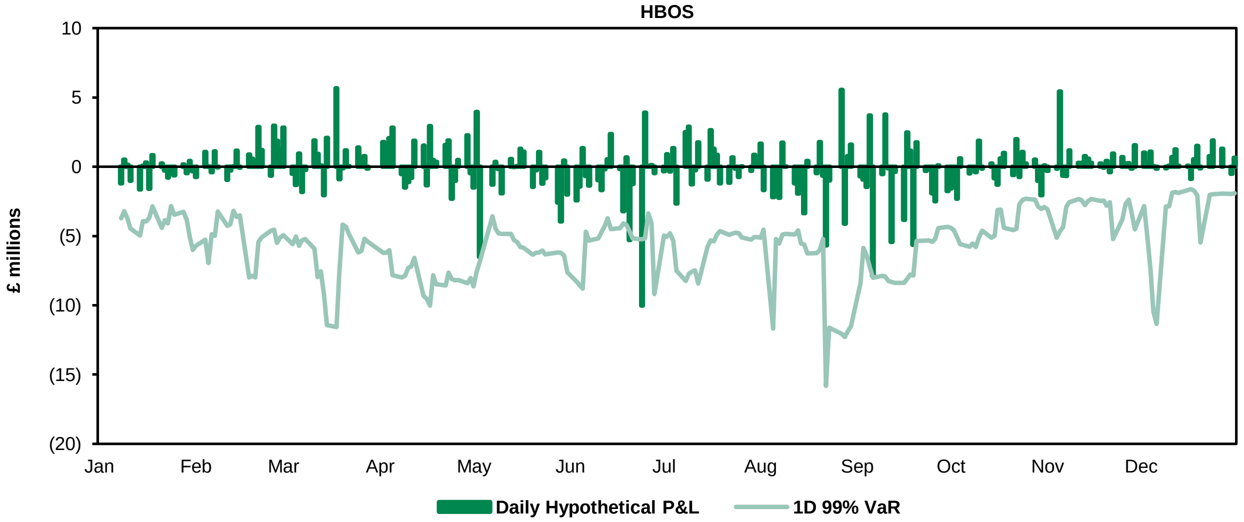
Trading Portfolios and Banking Activities

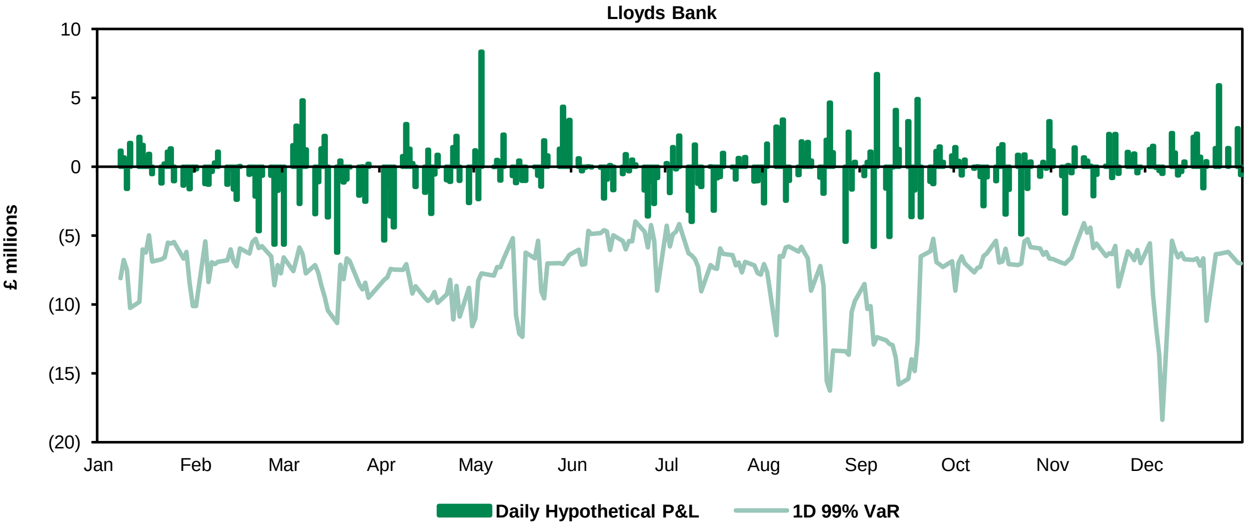
Trading is restricted to a number of specialist centres, the primary centre being the Financial Markets business in London. These centres also manage market risk in the wholesale non-trading portfolios, both in the UK and internationally. The level of exposure is strictly controlled and monitored within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

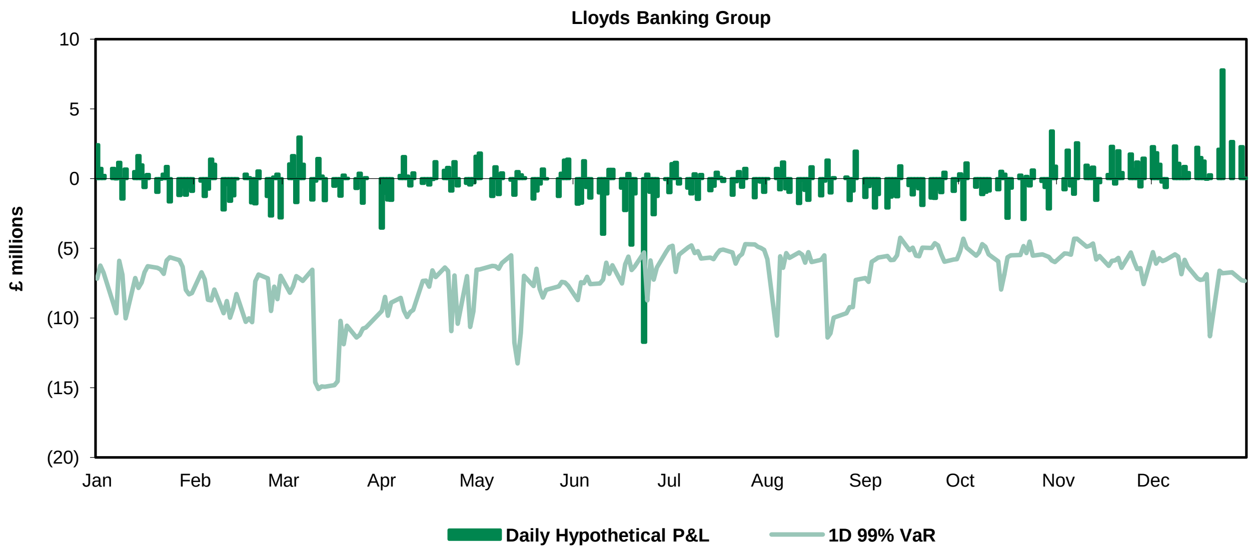
Market risk in the Group's divisional portfolios and in the Group's capital and funding activities is managed centrally within triggers defined in the Group policy for interest rate risk in the banking book, which is reviewed and approved annually.

Comparison of VaR to Hypothetical Profit and Loss

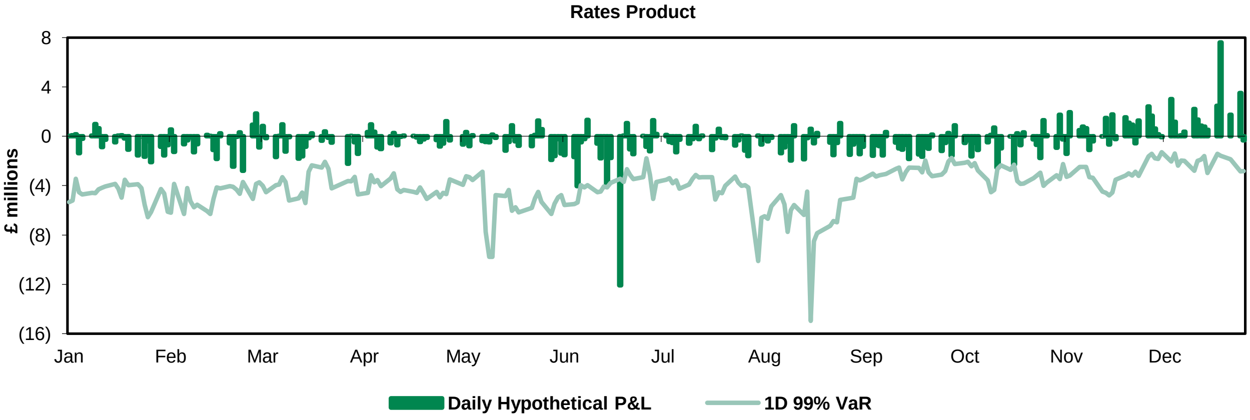
The following charts provide, by entity, a comparison of VaR (1-day 99 per cent confidence level) to the hypothetical profit and loss on a daily basis over the course of 2013. Backtesting exceptions that arose during period have been identified, with further analysis provided on page 109.

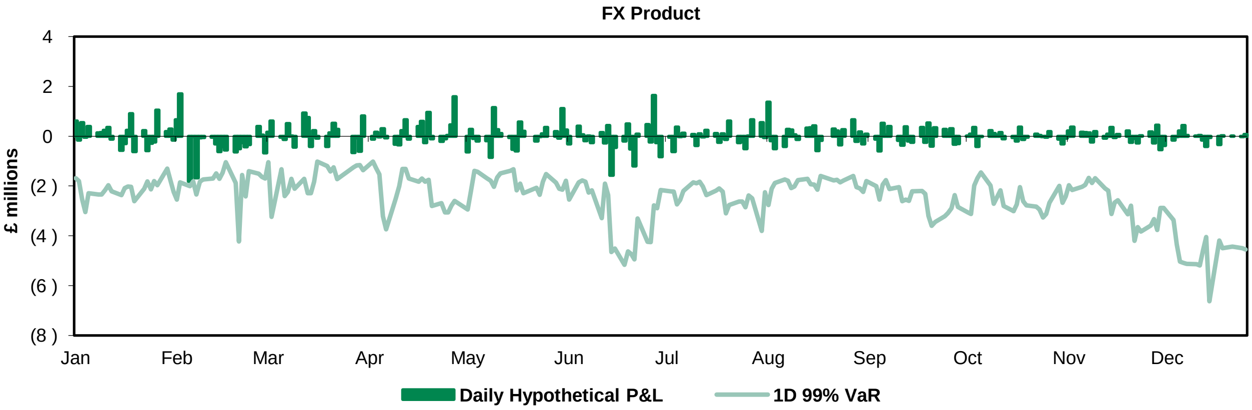


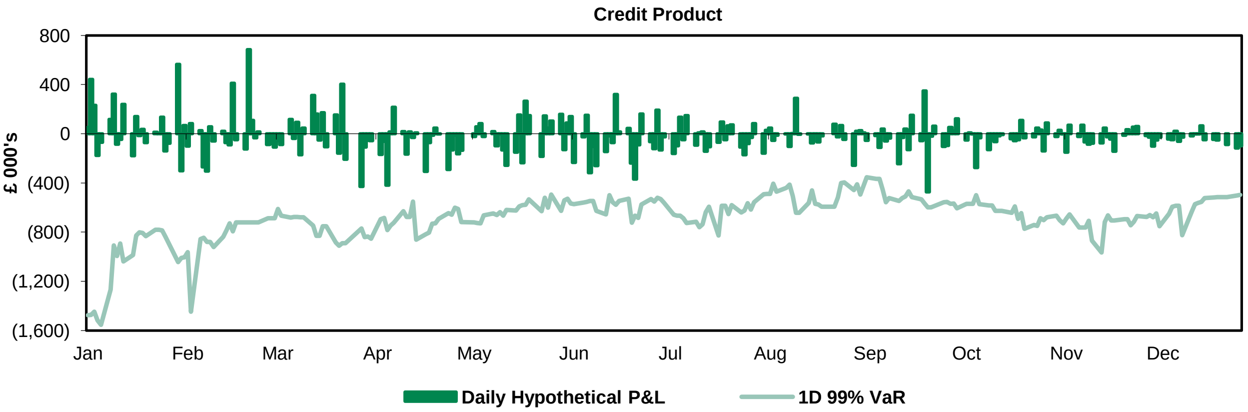


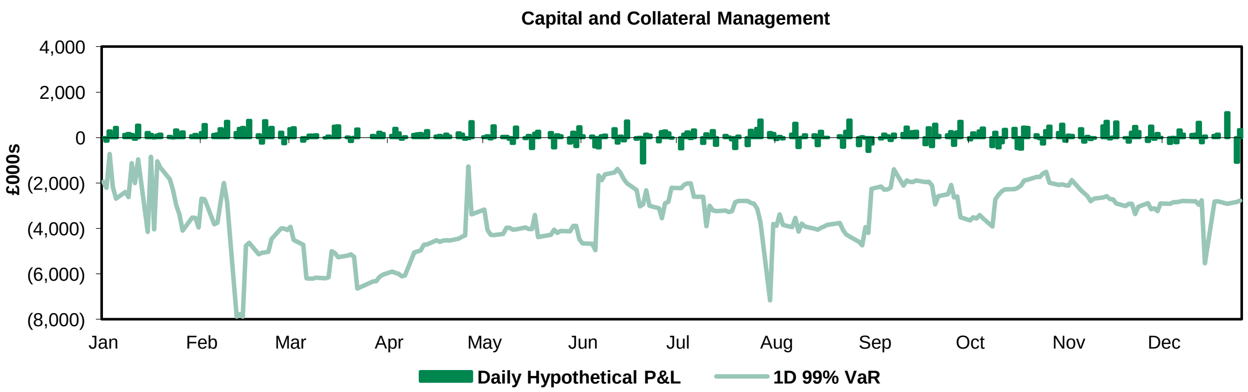


The following charts provide, by major business area, a comparison of VaR (1-day 99 per cent confidence level) to the hypothetical profit and loss on a daily basis over the course of 2013. Backtesting exceptions that arose during period have been identified, with further analysis provided on page 109.









OPERATIONAL RISK

DEFINITION

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The aim of operational risk management is to manage operational risks in line with defined appetites, and to protect both customers and the Group whilst delivering sustainable growth. The Group Operational Risk framework is the method by which operational risks are managed in terms of setting risk appetite, evaluating key exposures, measuring risk, mitigating risk, and monitoring risks on an ongoing basis, as set out below.

RISK APPETITE

The Group's Operational Risk Appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders. Appetite is expressed through five high level statements summarised below, each of which are defined with limits and triggers approved by the Board, and are regularly monitored by Executive and Board risk committees:

- **Customer:** The Group builds trust and does not expect its customers to be impacted negatively.
- **Reputation:** The Group manages its external profile effectively. The Group will manage and mitigate any prominent negative nationwide media coverage.
- **Financial loss:** The Group does not expect to experience cumulative fraud or operational losses above a defined level of budgeted Group income.
- **Management time and resources:** The Group does not expect internal events that divert excessive senior management time from running the business or have an extensive impact on colleague time and / or morale.
- **Risk culture:** All colleagues are responsible for risk within their individual roles. The Group sets a strong tone from the top, embraces a risk culture across the business which is aligned to its strategy, vision, values and codes of responsibility. The Group encourages an open dialogue and rapid escalation of potential threats and events.

EXPOSURES

The principal operational risks to the Group are:

- IT systems and resilience risk arising from failure to develop, deliver and maintain effective IT solutions;
- Information security risk arising from information leakage, loss or theft;
- External fraud arising from an act of deception or omission;
- Cyber risk arising from malicious attacks on the Group via technology, networks and systems; and
- Risks arising from inadequate customer facing processes, including transactions, processing and information capture.

The risks below also have potential to negatively impact customers and the Group's future results:

- The sale of TSB may result in disruption of senior management's ability to lead and manage the Group effectively. In addition, the Group is committed to providing service for TSB, with potential for customer detriment, plus reputational and financial exposure for the Group in the event of any significant issues in maintaining services.
- Terrorist acts, other acts of war or hostility, geopolitical, pandemic or other such events and responses to those acts/events may create economic and political uncertainties, which could have a material adverse effect on UK and international macroeconomic conditions generally, and more specifically on the Group's results of operations, financial condition or prospects in ways that cannot necessarily be predicted.
- Systems and procedures in place to comply with increasingly complex and detailed anti-money laundering and anti-terrorism laws and regulations may not always be fully effective in preventing third parties from using the Group as a conduit for money laundering. Should the Group be associated with money laundering, its reputation could suffer and/or it could become subject to fines, sanctions and legal enforcement; any one of which could have a material adverse effect on operating results, financial condition and prospects.

MEASUREMENT

Operational risk is managed within a Board approved framework and risk appetite, as set out above. A variety of measures are used such as: scoring of potential risks, using impact and likelihood, with impact thresholds aligned to the risk appetite statements above; assessment of the effectiveness of controls; monitoring of events and losses by size, business unit and internal risk categories.

In 2013, the highest frequency of events occurred in external fraud (61.96 per cent) and execution, delivery and process management (24.58 per cent). Clients, products and business practices accounted for 39.66 per cent of losses. Execution, delivery and process management accounted for 38.64 per cent of losses. Losses in both categories are driven by legacy issues (excluding PPI).

The table below shows high level loss and event trends using Basel framework categories.

Table 94: **Operational risk events by risk category**

	% of total volume		% of total losses	
	2013	2012	2013	2012
Business disruption and system failures	0.92%	1.08%	0.86%	1.46%
Clients, products and business practices	11.02%	15.27%	39.66%	58.65%
Damage to physical assets	0.81%	0.32%	0.45%	0.24%
Employee practices and workplace safety	0.61%	0.14%	0.36%	0.10%
Execution, delivery and process management	24.58%	24.90%	38.64%	27.19%
External fraud	61.96%	58.02%	20.01%	11.99%
Internal fraud	0.10%	0.27%	0.02%	0.37%
Total	100.00%	100.00%	100.00%	100.00%

Operational risk exposure and actual losses are used by the Group to calculate the appropriate holding of operational risk regulatory capital under the Internal Capital Adequacy Assessment Process (ICAAP). The Group calculates its operational risk capital requirements using the Standardised Approach ('TSA'), which the Basel Committee states as being appropriate for an 'internationally active' bank.

MITIGATION

The Group's control environment receives regular review and investment, with reporting on the material risks discussed monthly by senior management. Risks are managed via a range of strategies – avoidance, mitigation, transfer (including insurance), and acceptance, and contingency plans maintained for a range of potential scenarios with a regime of regular disaster recovery exercises, both Group specific and industry wide. Mitigating actions for the principal risks above include:

- The Group completed a strategic review in 2013, focused on IT resilience (the ability of IT systems to resist and/or recover from failure). Actions from the review include implementation of a new Group-wide risk appetite for IT service and availability based on the processes most time-critical to the Group's customers, or to manage the Group. Strategic enhancements and investment are in plan over the next three years to reflect enhanced demands on IT both in terms of customer and regulator expectations.

- The Group has, and will continue to, invest in enhanced protection of customer information, including access to key systems and the security, durability and accessibility of critical records.

- The Group adopts a risk based approach to mitigate the external fraud risks it faces, reflecting the current and emerging external fraud risks within the market. This approach drives an annual programme of enhancements to the Group's technology, process and people related controls, with an emphasis on preventative controls supported by real time detective controls wherever feasible. Through Group-wide policies and operational control frameworks, the Group has developed a robust fraud operating model with centralised accountability. The Group's fraud awareness programme is a key component of its fraud control environment.

- Significant investment has been made in increasing the Group's cyber defence, for example through the IT Security Improvement Programme, to protect customers and the Group's infrastructure.

- The Group continues to place appropriate and significant focus on improving customer processing by remediating known issues and addressing root cause through its rectification programmes, and seeking to improve the overall servicing environment in key areas through the Simplification programme. In addition, incident management capability has been revised and enhanced to increase speed of response to customer impacting incidents.

- The level and impact of change involved in the sale of TSB is managed via robust change management governance and a consolidated strategic change plan. There are separate governance arrangements in place to oversee the impacts of the divestment on the retained business customers, operations and controls.

- Operational resilience measures and recovery planning defined in the Group's Business Continuity Management Policy ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats including environmental and climatic issues, terrorism, economic instability, pandemic planning and operational incidents.

- The Group has adopted policies and procedures to detect and prevent the use of its banking network for money laundering and related activities, and it regularly reviews and assesses these to keep them current and effective. These activities include 'know-your-customer' requirements, training and awareness, transaction monitoring technologies and reporting of suspicions of money laundering to the applicable regulatory authorities.

MONITORING

Monitoring and reporting is undertaken at Board, Group and business area committees, in accordance with delegated limits of authority which are regularly reviewed and refreshed. Business unit risk exposure is aggregated and discussed at the monthly Group Operational Risk Committee, and matters are escalated to the Chief Risk Officer, or higher committees, if appropriate. A combination of systems, monthly reports from business areas, and oversight and challenge from the Risk Division; audit; and assurance teams ensures that key risks are regularly presented and debated by an Executive audience.

The Group maintains a formal approach to operational risk event escalation, whereby material events are identified, captured and escalated. Root causes of events are determined and action plans put in place to ensure an optimum level of control to keep customers and the business safe, reduce costs, and improve efficiency.

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.

OPERATIONAL RISK CAPITAL REQUIREMENT

As at 31 December 2013, the capital requirement in respect of operational risk amounted to £2,128m (2012: £2,235m), as determined under The Standardised Approach.

APPENDIX 1

CRD IV TRANSITIONAL AND FULLY LOADED CAPITAL POSITIONS

DETAILED ANALYSIS

CRD IV TRANSITIONAL AND FULLY LOADED CAPITAL POSITIONS

The following table, disclosed at the request of the PRA, provides a detailed reconciliation between accounting capital at 31 December 2013, as published in the 2013 Lloyds Banking Group plc Annual Report and Accounts, and the CRD IV transitional and fully loaded capital positions.

The reconciliation between accounting capital and the CRD IV transitional capital position is shown as if 2013 was Year 1 of the transition period. The format and content of the reconciliation follows the instructions and format set out in Annex VI ('Transitional own funds disclosure template') to the EBA Draft Implementing Technical Standards on Disclosure for Own Funds by institutions.

The table below lays out the CRD IV capital position at 31 December 2013 on the same basis as the summarised table on page 26.

Table 95: **Detailed analysis of CRD IV transitional and fully loaded capital positions**

AS AT 31st DECEMBER 2013	CRD IV Transitional Rules [1] £m	Movement from Transitional to Fully Loaded £m	CRD IV Fully Loaded Rules £m
Common equity tier 1 (CET1) capital: instruments and reserves			
Capital instruments and related share premium accounts	24,424	-	24,424
of which: called up share capital	7,145	-	7,145
of which: share premium	17,279	-	17,279
Retained earnings	2,604	-	2,604
Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	10,477	-	10,477
Minority interests (amount allowed in consolidated CET1)	-	-	-
Common equity tier 1 (CET1) capital before regulatory adjustments	37,505	-	37,505
Common equity tier 1 (CET1) capital: regulatory adjustments			
Additional value adjustments	(300)	-	(300)
Intangible assets (net of related tax liability)	(1,979)	-	(1,979)
Deferred tax assets that rely on future profitability, excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) of the CRR are met)	(5,025)	-	(5,025)
Fair value reserves related to gains or losses on cash flow hedges	1,055	-	1,055
Negative amounts resulting from the calculation of expected loss amounts	(866)	-	(866)
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	185	-	185
Defined benefit pension fund assets	(78)	-	(78)
Direct, indirect and synthetic holdings by the Group of the CET1 instruments of financial sector entities where the Group has a significant investment in those entities (amount above 10% threshold and net of eligible short positions)	(2,909)	-	(2,909)
Exposure amount of the following items which qualify for a risk weight of 1,250%, where the Group has opted for the deduction alternative	(141)	-	(141)
of which: securitisation positions	(141)	-	(141)
Amount exceeding the 15% threshold	-	(406)	(406)
of which: Direct, indirect and synthetic holdings by the Group of the CET1 instruments of financial sector entities where the Group has a significant investment in those entities	-	(276)	(276)
of which: deferred tax assets arising from temporary differences	-	(130)	(130)
Regulatory adjustments applied to common equity tier 1 (CET1) in respect of amounts subject to pre-CRR treatment			
Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468 of the CRR	-	-	-
Total regulatory adjustments applied to common equity tier 1 (CET1)	(10,058)	(406)	(10,464)
COMMON EQUITY TIER 1 (CET1) CAPITAL	27,447	(406)	27,041
Additional tier 1 (AT1) capital: instruments			
Capital instruments and related share premium accounts	804	(804)	-
of which: classified as liabilities under applicable accounting standards	804	(804)	-
Qualifying own funds instruments included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	3,682	(3,682)	-
Additional tier 1 (AT1) capital before regulatory adjustments	4,486	(4,486)	-
Additional tier 1 (AT1) capital: regulatory adjustments			
Residual amounts deducted from additional tier 1 (AT1) capital with regard to deductions from common equity tier 1 (CET1) capital during the transitional period pursuant to Article 472 of the CRR	-	-	-
Residual amounts deducted from additional tier 1 (AT1) capital with regard to deductions from tier 2 (T2) capital during the transitional period pursuant to Article 475 of the CRR	(677)	677	-
of which: significant investments	(677)	677	-
Total regulatory adjustments applied to additional tier 1 (AT1) capital	(677)	677	-
Additional tier 1 (AT1) capital	3,809	(3,809)	-
TIER 1 CAPITAL	31,256	(4,215)	27,041

Table continued on next page

	CRD IV Transitional Rules [1]	Movement from Transitional to Fully Loaded	CRD IV Fully Loaded Rules
	£m	£m	£m
Tier 2 (T2) capital: Instruments and provisions			
Capital instruments and related share premium accounts	129	793	922
Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	19,741	(5,027)	14,714
Credit risk adjustments	349	-	349
Tier 2 (T2) capital before regulatory adjustments	20,219	(4,234)	15,985
Tier (T2) capital: regulatory adjustments			
Direct, indirect and synthetic holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions)	(338)	(1,354)	(1,692)
Residual amounts deducted from tier 2 (T2) capital with regard to deductions from common equity tier 1 (CET1) capital during the transitional period pursuant to Article 472 of the CRR	-	-	-
Regulatory adjustments applied to tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013	(677)	677	-
Amount to be deducted from or added to additional tier 2 (AT2) capital with regard to additional filters and deductions required pre CRR	-	-	-
Total regulatory adjustments applied to tier 2 (T2) capital	(1,015)	(677)	(1,692)
TIER 2 (T2) CAPITAL	19,204	(4,911)	14,293
TOTAL CAPITAL	50,460	(9,126)	41,334

[1] The transitional disclosure is based on the final policy statement (PS7/13) implementing CRD IV, issued by the PRA on 19 December 2013. This differs from transitional rules applied in previously published statements, which assumed the minimum transitional phasing allowed by CRD IV, consistent with the FSA's previous policy statement 'CRD IV transitional provisions on capital resources' published on 26 October 2012 via the FSA website. The PRA policy statement (PS7/13) does not permit UK financial institutions to apply CRD IV transitional provisions to any element of CET1, with the exception of available-for-sale gains, and therefore the transitional CET1 position based on this statement is significantly lower than under the CRD IV minimum transitional phasing previously disclosed.

Notes on Transitional Phasing

The key impacts of the CRD IV rules, as implemented by PRA policy statement PS7/13, on capital resources are detailed below.

The transitional rules, as implemented by PS7/13, result in all CET1 deductions being recognised immediately with no transitional relief. Transitional phasing still applies to additional tier 1 and tier 2 capital instruments and deductions, further explained below.

- Deconsolidation of insurance undertakings in reserves: Under the rules prevailing at 31 December 2013, the Group's consolidated reserves include post acquisition reserves of the Group's unconsolidated insurance businesses, which are then reflected in the value of the deduction from goodwill and material holdings (from tier 1 and tier 2 capital). Under CRD IV insurance post acquisition reserves are excluded from the consolidated banking reserves position. The Group's investment in insurance entities (measured on an historical cost basis) is deducted from CET1 and the deduction for goodwill reduced. The net impact of this change in treatment is negligible.

- Surplus non-controlling interests: Stricter CRD IV requirements for inclusion of non-controlling interests result in the Group's current CET1 non-controlling interests no longer counting under CRD IV.

- Unrealised reserves on available-for-sale assets (AFS): Unrealised gains continue to be filtered out in 2014, with losses fully included in CET1.

- Additional deductions for Debit Valuation Adjustments (DVA) and Prudent Valuation Adjustments (PVA): Under CRD IV, additional deductions relating to the prudent valuations of fair valued assets and the removal of fair value movements on derivative liabilities arising from changes in own credit spreads are recognised against CET1.

- Excess of expected losses over impairment provisions (EEL) and securitisation positions: Deducted 100 per cent from CET1, previously 50 per cent from core tier 1 and 50 per cent from tier 2. EEL amounts under CRD IV include the offset of additional value adjustments relating to PVA. Any surplus of provisions over expected losses arising on the defaulted portfolio are reflected in tier 2 rather than offset against EEL.

- Deferred tax assets (excluding temporary differences): Deducted from CET1, previously risk weighted at 100 per cent.

- Significant Investments and deferred tax (temporary differences) under the threshold approach: Holdings of more than 10 per cent of the CET1 of financial sector entities (including the Group's insurance businesses) not included in the regulatory consolidation are subject to a threshold approach along with deferred tax assets relating to temporary differences. Under this approach the amount of significant investments and deferred tax assets which individually exceed 10 per cent and in aggregate exceed 15 per cent of the Group's CET1 are deducted from CET1, with amounts below the threshold risk weighted at 250 per cent. The calculation of this threshold differs slightly under transition compared to the end point calculation, resulting in a slightly higher risk weighted asset compared to deduction under transition.

- Significant investment holdings in the tier 1 and tier 2 capital of financial sector entities were previously deducted 50 per cent against the Group's tier 1 capital and 50 per cent against tier 2 capital. Under CRD IV, these investments are deducted from the corresponding tier of capital, with this revised treatment phasing in from the previous approach over the transitional period.

- Non significant investments: Holdings of less than 10 per cent of the CET1 of financial sector entities are deducted to the extent the aggregate of such holdings (including any holdings of tier 1 and tier 2) exceeds 10 per cent of the Group's CET1. The Group's non significant holdings do not currently exceed this threshold and therefore continue to be risk weighted.

- Qualifying holdings: Holdings in non financial sector entities are deducted from CET1 to the extent these individually exceed 15 per cent and in aggregate exceed 60 per cent of the Group's eligible capital. Such holdings do not currently exceed this threshold and therefore continue to be risk weighted.

- Tier 1 and tier 2 capital: Stricter CRD IV requirements for additional tier 1 and tier 2 instruments result in all tier 1 instruments and some tier 2 instruments becoming ineligible and subject to grandfathering provisions which apply during transition. In addition, capital instruments issued by subsidiaries are subject to a surplus calculation, with any excess over minimum requirements attributable to third parties not recognised within the group's capital.

- Eligible provisions: Collectively assessed impairment provisions for the Standardised Approach portfolios are no longer included within tier 2, instead a corresponding reduction is made to Standardised Approach exposures. Eligible provisions under CRD IV include any defaulted provision restriction included within the EEL position as outlined above.

- Risk weighted assets (RWAs): Additional RWAs are recognised under CRD IV and primarily include counterparty credit risk arising from credit valuation adjustment (CVA) volatility and financial institutions interconnectedness, partially offset by reductions arising from the SME scalar. Additional RWAs also arise from the risk weighting of significant investments and deferred tax temporary differences noted above.

APPENDIX 2

LLOYDS BANK GROUP

CAPITAL RESOURCES AND CAPITAL REQUIREMENTS

LLOYDS BANK GROUP CAPITAL RESOURCES

The capital resources of Lloyds Bank Group as at 31 December 2013 are presented in the table below.

Table 96: **Lloyds Bank Group capital resources**

	2013		2012 [2]	
	£m	£m	£m	£m
Core tier 1				
Shareholders' equity per balance sheet		43,739		48,401
Non-controlling interests per balance sheet		347		685
Regulatory adjustments:				
Regulatory adjustments to non-controlling interests		(315)		(628)
Adjustment for own credit		185		217
Defined benefit pension adjustment		(78)		(1,438)
Unrealised reserve on available-for-sale debt securities		1,408		315
Unrealised reserve on available-for-sale equity investments		(135)		(56)
Cash flow hedging reserve		827		(590)
Other items		452		33
		46,430		46,939
Less: deductions from core tier 1				
Goodwill		(2,016)		(2,016)
Intangible assets		(1,799)		(2,091)
50% excess of expected losses over impairment provisions		(373)		(636)
50% of securitisation positions		(71)		(183)
Core tier 1 capital		42,171		42,013
Non-controlling preference shares [1]		2,585		2,343
Preferred securities [1]		3,882		4,766
Less: deductions from tier 1				
50% of material holdings		(3,859)		(46)
Total tier 1 capital		44,779		49,076
Total tier 1 capital (excluding preferred securities)	*40,897*		*44,310*	
Tier 2				
Undated subordinated debt		1,150		1,996
Dated subordinated debt		19,815		21,082
Unrealised gains on available-for-sale equity investments		135		56
Eligible provisions		359		977
Less: deductions from tier 2				
50% excess of expected losses over impairment provisions		(373)		(636)
50% of securitisation positions		(71)		(183)
50% of material holdings		(3,859)		(46)
Total tier 2 capital		17,156		23,246
Total tier 2 capital (including preferred securities)	*21,038*		*28,012*	
Supervisory deductions				
Unconsolidated investments – life		-		(10,104)
Unconsolidated investments – general insurance and other		-		(929)
Connected lending of a capital nature		(3,275)		(10,159)
Total supervisory deductions		(3,275)		(21,192)
Total Capital Resources		58,660		51,130
Risk Weighted Assets		263,850		310,299
Core tier 1 capital ratio (%)		16.0%		13.5%
Tier 1 capital ratio (%)		17.0%		15.8%
Total capital ratio (%)		22.2%		16.5%

Notes

[1] Non-controlling preference shares and preferred securities represent the Group's hybrid capital securities. These are included within tier 1 capital in accordance with grandfathering provisions issued by the PRA (GENPRU TP 8A).

[2] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

LLOYDS BANK GROUP RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of Lloyds Bank Group as at 31 December 2013 are presented in the table below.

Table 97: **Lloyds Bank Group capital requirements**

(All figures are in £m)	2013 Risk Weighted Assets	2013 Pillar 1 Capital Requirements	2012 Risk Weighted Assets	2012 Pillar 1 Capital Requirements
CREDIT RISK				
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate - Main	48,771	3,902	54,835	4,387
Corporate - SME	10,570	846	12,628	1,010
Corporate - Specialised lending	100	8	5,368	429
Central governments and central banks	1,579	126	1,437	115
Institutions	1,339	107	1,447	116
Retail IRB Approach				
Retail - Residential mortgages	52,513	4,201	56,527	4,522
Retail - Qualifying revolving retail exposures	16,355	1,308	17,261	1,381
Retail - Other retail	13,671	1,094	15,206	1,216
Retail - SME	2,600	208	2,451	196
Other IRB Approaches				
Corporate - Specialised lending	20,511	1,641	4,897	392
Equities - Exchange traded	307	24	248	20
Equities - Private equity	5,140	411	4,917	393
Equities - Other	455	36	544	44
Securitisation positions	3,319	266	6,687	535
Total - IRB Approach	177,230	14,178	184,453	14,756
Exposures subject to the Standardised Approach				
Central governments and central banks	49	4	105	9
Regional governments or local authorities	-	-	18	1
Administrative bodies and non-commercial undertakings	9	1	62	5
Multilateral development banks	-	-	-	-
Institutions	295	24	566	45
Corporates	16,974	1,358	25,537	2,043
Retail	4,023	322	5,604	448
Secured by mortgages on residential property	2,535	203	6,950	556
Secured by mortgages on commercial real estate	206	16	15,200	1,216
Past due items	2,742	219	6,218	498
Items belonging to regulatory high risk categories	1	-	1	-
Short term claims on institutions or corporates	830	66	187	15
Collective investment undertakings	49	4	53	4
Other items	13,437	1,075	13,164	1,053
Total - Standardised Approach	41,150	3,292	73,665	5,893
Total Credit Risk	218,380	17,470	258,118	20,649
COUNTERPARTY CREDIT RISK				
IRB Approach	7,082	566	6,162	493
Standardised Approach	712	57	6,686	535
Total Counterparty Credit Risk	7,794	623	12,848	1,028
MARKET RISK				
Internal Models Approach	9,031	723	9,316	746
Standardised Approach				
Interest rate position risk requirement	1,557	125	1,719	138
Foreign currency position risk requirement	341	27	291	23
Equity position risk requirement	11	1	41	3
Commodity position risk requirement	-	-	5	-
Specific interest rate risk of securitisation positions	142	11	22	2
Total Market Risk	11,082	887	11,394	912
OPERATIONAL RISK				
Standardised Approach	26,594	2,128	27,939	2,235
Total Operational Risk	26,594	2,128	27,939	2,235
TOTAL	263,850	21,108	310,299	24,824

APPENDIX 3

BOS GROUP

CAPITAL RESOURCES AND CAPITAL REQUIREMENTS

BOS GROUP CAPITAL RESOURCES

The capital resources of BOS Group as at 31 December 2013 are presented in the table below.

Table 98: **BOS Group capital resources**

	2013		2012 [2]	
	£m	£m	£m	£m
Core tier 1				
Shareholders' equity per balance sheet		18,354		18,114
Non-controlling interests per balance sheet		20		20
Regulatory adjustments:				
Regulatory adjustments to non-controlling interests		(20)		7
Unrealised reserve on available-for-sale debt securities		58		178
Unrealised reserve on available-for-sale equity investments		(84)		(33)
Cash flow hedging reserve		(907)		(1,238)
		17,421		17,048
Less: deductions from core tier 1				
Goodwill		(334)		(374)
Intangible assets		(95)		(92)
50% excess of expected losses over impairment provisions		(152)		(550)
50% of securitisation positions		(48)		(113)
Core tier 1 capital		16,792		15,919
Preferred securities [1]		699		700
Less: deductions from tier 1				
50% of material holdings		(41)		(3)
Total tier 1 capital		17,450		16,616
Total tier 1 capital (excluding preferred securities)	*16,751*		*15,916*	
Tier 2				
Undated subordinated debt		4,754		4,776
Dated subordinated debt		7,540		7,530
Unrealised gains on available-for-sale equity investments		84		33
Eligible provisions		355		942
Less: deductions from tier 2				
50% excess of expected losses over impairment provisions		(152)		(550)
50% of securitisation positions		(48)		(113)
50% of material holdings		(41)		(3)
Total tier 2 capital		12,492		12,615
Total tier 2 capital (including preferred securities)	*13,191*		*13,315*	
Supervisory Deductions				
Unconsolidated investments		-		(64)
Connected lending of a capital nature		(2,029)		(855)
Total supervisory deductions		(2,029)		(919)
Total Capital Resources		27,913		28,312
Risk Weighted Assets		110,146		162,582
Core tier 1 capital ratio (%)		15.2%		9.8%
Tier 1 capital ratio (%)		15.8%		10.2%
Total capital ratio (%)		25.3%		17.4%

Notes

[1] Preferred securities represent the Group's hybrid capital securities. These are included within tier 1 capital in accordance with grandfathering provisions issued by the PRA (GENPRU TP 8A).

[2] 31 December 2012 comparatives have not been restated to reflect the implementation of IAS 19R and IFRS 10.

BOS GROUP RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of BOS Group as at 31 December 2013 are presented in the table below.

Table 99: **BOS Group capital requirements**

(All figures are in £m)	2013 Risk Weighted Assets £m	2013 Pillar 1 Capital Requirements £m	2012 Risk Weighted Assets £m	2012 Pillar 1 Capital Requirements £m
CREDIT RISK				
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate - Main	6,271	502	13,534	1,083
Corporate - SME	2,663	213	4,334	347
Central governments and central banks	140	11	99	8
Institutions	324	26	568	45
Retail IRB Approach				
Retail - Residential mortgages	37,635	3,011	41,885	3,351
Retail - Qualifying revolving retail exposures	7,761	621	8,307	665
Retail - Other retail	3,497	280	3,946	316
Other IRB Approaches				
Corporate - Specialised lending	10,971	878	1,026	82
Equities - Exchange traded	2	-	217	17
Equities - Private equity	1,063	85	1,187	95
Equities - Other	476	38	544	43
Securitisation positions	818	65	2,652	212
Total - IRB Approach	71,621	5,730	78,299	6,264
Exposures subject to the Standardised Approach				
Central governments and central banks	39	3	-	-
Regional governments or local authorities	-	-	18	1
Administrative bodies and non-commercial undertakings	9	1	59	5
Institutions	65	5	158	13
Corporates	8,535	683	20,356	1,628
Retail	2,582	207	4,032	323
Secured by mortgages on residential property	1,604	128	5,210	417
Secured by mortgages on commercial real estate	206	17	14,898	1,192
Past due items	2,476	198	5,630	450
Items belonging to regulatory high risk categories	1	-	1	-
Short term claims on institutions or corporates	830	66	187	15
Collective investment undertakings	31	2	38	3
Other items	5,650	452	6,720	538
Total - Standardised Approach	22,028	1,762	57,307	4,585
Total Credit Risk	93,649	7,492	135,606	10,849
COUNTERPARTY CREDIT RISK				
IRB Approach	2,519	202	592	47
Standardised Approach	331	26	6,532	523
Total Counterparty Credit Risk	2,850	228	7,124	570
MARKET RISK				
Internal Models Approach	3,007	241	4,766	381
Standardised Approach				
Interest rate position risk requirement	133	11	454	36
Foreign currency position risk requirement	204	16	47	4
Equity position risk requirement	11	1	41	3
Total Market Risk	3,355	269	5,308	424
OPERATIONAL RISK				
Standardised Approach	10,292	823	14,544	1,163
Total Operational Risk	10,292	823	14,544	1,163
TOTAL	110,146	8,812	162,582	13,006

APPENDIX 4

REMUNERATION DISCLOSURES

REMUNERATION DISCLOSURES

This section discloses the remuneration awards made by the Group to 140 Code Staff (2012: 139) in respect of the 2013 performance year. Additional information summarising the Group's decision-making policies for remuneration is also provided. These disclosures deliver the requirements of the PRA's Prudential Sourcebook for Banks, Building Societies and Investment Firms and the Capital Requirements Regulations, to the extent applicable to the 2013 performance year.

Code Staff

The following groups of individuals have been identified as meeting the criteria for Code Staff being those who have a material impact on the Group's risk profile, which includes:

- Senior Management, Executive Board Directors, members of the Group Executive Committee ('GEC') and their respective direct reports;
- Non Executive Directors;
- Approved Persons performing Significant Influence Functions; and
- Other highly remunerated individuals whose activities could have an impact on the Group's risk profile.

For performance year 2013 there were 140 Code Staff (2012: 139) identified across the Group.

Aggregate Remuneration Expenditure (Code Staff)

Table 100: **Analysis of aggregate remuneration expenditure by division**

	Dec 2013 Retail £m	Dec 2013 Commercial Banking £m	Dec 2013 WAFI £m	Dec 2013 Insurance £m	Dec 2013 Group Operations £m	Dec 2013 Group Functions £m	Dec 2013 TOTAL £m
Aggregate remuneration expenditure	**8.6**	**16.4**	**6.9**	**0.9**	**5.5**	**42.2**	**80.5**

	Dec 2012 Retail £m	Dec 2012 Commercial Banking £m	Dec 2012 WAFI £m	Dec 2012 Insurance £m	Dec 2012 Group Operations £m	Dec 2012 Group Functions £m	Dec 2010 TOTAL £m
Aggregate remuneration expenditure	7.9	14.8	6.8	0.6	5.6	35.6	71.3

Analysis of Remuneration between Fixed and Variable Amounts

Table 101: **Analysis of remuneration between fixed and variable amounts**

	Dec 2013 Total	Dec 2013 Senior Managers [1]	Dec 2013 Others
Number of Code Staff	**140**	**102**	**38**
	£m	**£m**	**£m**
Fixed:			
Cash based	**33.1**	**23.8**	**9.3**
Total Fixed Pay	**33.1**	**23.8**	**9.3**
Variable:			
Cash	**0.2**	**0.2**	**0.0**
Retained shares [2]	**14.1**	**10.9**	**3.2**
Deferred shares	**15.2**	**13.1**	**2.1**
Total Variable Pay	**29.5**	**24.2**	**5.3**
LTIP [3]	**17.9**	**16.0**	**1.9**

Notes

[1] Senior Managers are defined as Group Executive Committee ('GEC') members / attendees and their direct reports (excluding those direct reports who do not materially influence the risk profile of any CRD III in-scope group firm, which includes direct reports of GEC members / attendees in Insurance, Audit, Customer Products, Group Corporate Affairs, Marketing and Customer Development and Human Resources where they are not also Approved Persons). In addition, a number of individuals identified as registered persons under CF1-29 also meet the definition of Senior Managers and are therefore reported in this latter category.

[2] Shares subject to retention period.

[3] Notional value.

	Dec 2012 Total	Dec 2012 Senior Managers [1]	Dec 2012 Others
Number of Code Staff	139	103	36
	£m	£m	£m
Fixed:			
Cash based	31.7	26.2	5.5
Total Fixed Pay	31.7	26.2	5.5
Variable:			
Cash	0.2	0.2	0.0
Retained shares [2]	12.1	8.5	3.6
Deferred shares	16.7	12.3	4.4
Total Variable Pay	29.0	21.0	8.0
LTIP [3]	10.6	9.3	1.3

Notes

[1] As at 31 December 2012, Senior Managers were defined as Group Executive Committee ('GEC') members and their direct reports (excluding the direct reports of the Group Director, Insurance and the Group Corporate Affairs Director, where they are not also Approved Persons). In addition, a number of individuals identified as registered persons under CF1-29 also met the definition of Senior Managers and were therefore reported in this latter category.

[2] Shares subject to retention period.

[3] Notional value.

Analysis of Deferred Remuneration

Table 102: **Analysis of deferred remuneration**

	2013 Code Staff £m
Deferred remuneration at 31 December 2013	
Outstanding, vested	-
Outstanding, unvested	189.1
Awarded during the financial year	85.7
Paid out	16.5
Reduced through performance adjustment [1]	1.3

Notes

[1] This figure does not include the adjusted value of awards which were forfeited by colleagues upon leaving the Group. In addition, the Remuneration Committee has recommended to the Board that it should again exercise its discretion to adjust the value of certain bonus awards, on a basis equivalent to that applied in the previous year. Any adjustments in this respect will be made in 2014.

	2012 Code Staff £m
Deferred remuneration at 31 December 2012	
Outstanding, vested	-
Outstanding, unvested	106.9
Awarded during the financial year	68.6
Paid out	13.7
Reduced through performance adjustment [1]	0.6

Notes

[1] This figure does not include the adjusted value of awards which were forfeited by colleagues upon leaving the Group. In addition, the Remuneration Committee had recommended to the Board that it should again exercise its discretion to adjust the value of certain 2010 bonus awards, on a basis equivalent to that applied in the previous year. Any adjustments in this respect were made in 2013.

Analysis of Sign-On and Severance Payments

Table 103: **Analysis of sign-on and severance payments**

	Dec 2013 Code Staff
Severance payments	
Made during the year	£0.07m
Number of beneficiaries	5
Highest such award to a single person	£0.03m

	Dec 2012 Code Staff
Severance payments	
Made during the year	£0.2m
Number of beneficiaries	2
Highest such award to a single person	£0.1m

There were no sign-on awards made to Code Staff during 2013 (2012: nil).

Analysis of High Earners by Band

Table 104: **Analysis of high earners by band**

Number of code staff paid €1 million[1] or more for 2013	Dec 2013 Code Staff
€1.0m - €1.5m	12
€1.5m - €2.0m	5
€2.0m - €2.5m	4
€2.5m - €3.0m	3
€3.0m - €3.5m	-
€3.5m - €4.0m	2
€4.0m - €4.5m	-
€4.5m - €5.0m	1

[1] Converted to Euros using the exchange rate €1 = £0.8496

Decision Making Process for Remuneration Policy

The Group has a strong belief in aligning the pay delivered to the Group's executives with the successful performance of the business and, through this, the return of value to the Group's shareholders. It has continued to seek the views of shareholders and other key stakeholders with regard to remuneration policy and seeks to motivate, incentivise and retain talent while being mindful of the economic outlook. An essential component of the Group's approach to remuneration is the governance process that underpins it. This ensures that the policy is robustly applied and risk is managed appropriately.

The overarching purpose of the Remuneration Committee is to consider, agree and recommend to the Board an overall remuneration policy and philosophy for the Group that is defined by, supports and is closely aligned to its long-term business strategy, business objectives, risk appetite and values and recognises the interests of relevant stakeholders. The Group has a conservative business model characterised by a risk culture founded on prudence and accountability. The remuneration policy and philosophy covers the whole Group, but the Committee pays particular attention to the top management population, including the highest paid employees in each division, 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 Group has a robust governance framework, with the Remuneration Committee reviewing all compensation decisions for Executive Directors, Senior Managers, senior risk and compliance officers and any other Code Staff or high earners. This approach to governance is cascaded through the Group with the Executive Compensation Committee having oversight for all other employees. Divisional Remuneration Committees, which include independent representation from control functions, provide an additional layer of governance. Control function employees themselves are assessed and their remuneration determined by the appropriate Control Function Director, and oversight is provided by a Functional Remuneration Committee.

Whilst there were no material changes to the overall structure of remuneration in 2013, the Group continued to maintain an open and transparent dialogue with shareholders. This valuable engagement is something the Group will seek to continue into 2014, given the responsibilities it has to the providers of the equity capital in setting fair and appropriate remuneration policies.

Recent European regulatory changes have introduced a cap on the variable element of remuneration at 100 per cent of fixed remuneration which may be increased to 200 per cent, but only with shareholder approval. These changes have led the Committee to review the remuneration package for directors and for staff under the scope of the regulation.

The Group continues to believe that fixed pay should be positioned competitively but conservatively against the market and that the variable pay offered to the Group's executives should be directly aligned to the delivery of value to the Group's shareholders.

To manage this an additional fixed element in the package is being proposed. This will take the form of a fixed share award, made annually, which will deliver shares over a period of five years. This will ensure that total fixed remuneration is commensurate with role and maintain the competitiveness of the package and particularly the alignment with shareholders in line with regulatory requirements.

Although the fixed element of the package will be increased, delivery of fixed compensation through shares ensures that over 75 per cent of remuneration for senior executives will remain aligned with shareholders' interests.

Composition of the Remuneration Committee

The members of the Committee during 2013 were Anthony Watson (chairman), Sir Winfried Bischoff, Carolyn Fairbairn, David Roberts (also chairman of the Risk Committee), Tim Ryan (until 18/04/13) and Sara Weller.

During 2013, the Committee met 10 times and considered the following principal matters:

- Review of remuneration arrangements for senior executives
- Determination of the appropriate remuneration packages for a number of senior new hires
- Determination of bonus pools based on Group performance and adjustment for risk
- Performance conditions for the Long-Term Incentive Plan
- Bonus and salary awards for Executive Directors and key senior managers
- Approval of remuneration and terms of service that fall within the Committee's terms of reference, including new appointments; and
- Feedback from the Remuneration Committee Chairman on his meetings with the PRA and shareholders.

Advice to the Committee

The Committee appoints independent consultants to provide advice on specific matters according to their particular expertise. During the year, Deloitte LLP advised the Committee. Deloitte was appointed following a competitive tendering process. Deloitte has voluntarily signed up to the Remuneration Consultants' Code of Conduct. The Committee has evaluated Deloitte during 2013 and judged its advice as objective and independent.

António Horta-Osório (Group Chief Executive), Rupert McNeil (Group HR Director) and Paul Hucknall (HR Director, Performance & Reward) provided guidance to the Committee (other than for their own remuneration). Juan Colombás (Chief Risk Officer) and George Culmer (Group Finance Director) also attended the Committee to advise as and when necessary on risk and financial matters.

Role of the Relevant Stakeholders

During 2013, the Committee has consulted extensively with UK Financial Investments (UKFI), and a number of other shareholders and key stakeholders, such as the Group's main regulators, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). Formal consultation on the remuneration of Executive Directors is not undertaken with employees. However, surveys are undertaken semi-annually on employee engagement and discussion on the Group's remuneration approach takes place with union representatives during the annual pay review cycle and on relevant employee reward matters.

Link Between Pay and Performance

The Group has a strong belief in aligning the pay delivered to the Group's executives with the successful performance of the business and, through this, the return of value to the Group's shareholders as set out in the Group's 2011 Strategic Review. To this end, the performance management process has been developed, with the close participation of the Group's Risk team, to embed performance measures across the Group's reward structure which are challenging and reflect Group and divisional achievement in addition to personal contribution.

The use of a balanced scorecard approach to measure long-term performance enables the Remuneration Committee to assess the performance of the Company and its senior executives in a consistent and performance-driven way. The Group's remuneration policy continues to support the business values and strategy, based on building long-term relationships with customers and employees and managing the financial consequences of business decisions across the entire economic cycle.

The policy is intended to ensure that the Group's remuneration proposition is both cost effective and enables us to attract and retain Executive Directors and senior management of the highest calibre, motivating them to perform to the highest standards.

The objective is to align individual reward with the Group's performance, the interests of its shareholders, and a prudent approach to risk management. In this way, the requirements of the Group's various stakeholders – its customers, shareholders, employees and regulators – are balanced. This approach is in line with the Association of British Insurers best practice code on remuneration and the PRA / FCA Remuneration Code, as the policy seeks to reward long-term value creation whilst not encouraging excessive risk-taking.

Annual and long-term incentives are based on stretching performance objectives and targets in the Group Balanced Scorecard. This Balanced Scorecard is derived from the five year operating plan which defines the financial and non-financial targets within the agreed risk appetite over a three year period.

In determining the payout under any component of variable pay, the adopted policy is the use of judgement to assess the extent to which performance has been achieved rather than applying a formulaic approach. The annual bonus for Executive Directors is deferred into shares and released over a period of not less than three years, helping to increase alignment with shareholders. All other Code Staff are subject to deferral at least in line with the Remuneration Code. These deferrals are subject to adjustment through the application of a regular performance adjustment review.

Design and Structure of Remuneration

Reward is delivered via a combination of fixed and variable pay. Taking into account the expected value of awards, the performance-related elements of pay make up a considerable proportion of the total remuneration package for Code Staff, whilst maintaining an appropriate balance between the fixed and variable elements.

The approximate make-up of the main components of the package for Executive Directors on an expected value basis is shown below:

Long-term incentive (variable)	30%
Short-term incentive (variable)	10%
Salary (fixed)	30%
Share award (fixed)	20%
Pension and benefits (fixed)	10%

The overall policy objective is met by a focus on the particular aspects detailed below.

Base salary

All Code Staff receive either salaries or fees (Non-Executive Directors). Base salaries are reviewed annually, taking into account individual performance and market information, and normally adjusted from 1 January of the relevant year.

Fixed share award

Recent European regulatory changes have introduced a cap on the variable element of remuneration at 100 per cent of fixed remuneration which may be increased to 200 per cent, but only with shareholder approval. The Remuneration Committee strongly believes in pay for performance, in providing a competitive package that allows the Group to attract and retain the key talent necessary to deliver the strategy set by the Board, and in ensuring fixed costs are properly managed. The Group is seeking shareholder approval to allow variable remuneration up to a maximum of 200 per cent of fixed remuneration.

The Group is proposing to introduce an additional fixed element in the package. This will take the form of a fixed share award, made annually, which will deliver Lloyds Banking Group shares over a period of five years. This will ensure that total fixed remuneration is commensurate with role and maintain the competitiveness of the package and particularly the alignment with shareholders in line with regulatory requirements.

Annual bonus plan

All Code Staff, excluding Non-Executive Directors, are eligible to be considered for an annual bonus. The annual bonus plan is designed to reflect specific goals linked to the performance of the business.

Awards are based upon individual contribution and overall Group results. Opportunity is driven by Group performance based on Underlying Profit and Economic Profit, together with divisional achievement and individual performance. Targets relevant to improving overall business performance are contained in Balanced Scorecards and are grouped under the following headings:

- Financial
- Building the Business
- Customer Service

- Risk
- People Development

These targets apply differently for the Executive Directors, reflecting differing strategic priorities.

Based on the Group's financial and balanced scorecard assessment, the Committee applied its judgement in determining the 2013 bonus pool outcome. It takes into consideration any other factors, particularly in relation to legacy and one-off issues, affordability, market positioning and year on year performance. The Committee considered that using a purely mechanical approach to determining the 2013 bonus pool and individual awards was not appropriate and therefore applied its judgement to reduce the overall Group pool.

The Remuneration Committee believes that the structure of the annual bonus – in particular the use of risk-adjusted and non-financial measures – has been highly successful in promoting a long-term focus within the senior management team.

Deferral and vesting

To ensure that the interests of Lloyds Banking Group and its employees are aligned with those of the shareholders, and that the approach to risk management supports the interests of all stakeholders, a proportion of bonus above certain thresholds is deferred into Lloyds Banking Group Shares. The 2013 annual bonus for Executive Directors is deferred in shares until at least March 2016 and is beyond the requirements of the PRA Remuneration Code. For all other Code Staff, bonus is deferred in line with the Code requirements. This deferred amount is subject to performance adjustment (malus) in accordance with the Group's Performance Adjustment Policy. The application of performance adjustment will generally be considered when:

- there is evidence of employee misbehaviour or material error whether or not that leads to disciplinary action or dismissal;
- there is a material failure of risk management at Group level, or in the business area, division and / or business unit in which the employee works;
- there are significant risk investigations or issues flagged by the PRA or FCA;
- the financial results at a Group, division or business unit level are re-stated or consideration is given to restatement; or
- the Remuneration Committee determines that the financial results for a given year do not support the level of variable remuneration awarded; or
- in any other circumstances where the Remuneration Committee or a Division or Function Remuneration Committee acting on their behalf considers adjustments should be made to the value of unreleased variable remuneration.

The Committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deem this appropriate.

Long-term incentives

The Long Term Incentive Plan remains a core part of the reward strategy and is an important tool for aligning the Group's reward strategy to the performance of the business. Through the application of carefully considered, stretching target measures, the Group can ensure that awards are forfeited or restricted where performance does not meet the desired level. This directly connects the financial reward for the executive and senior management team with the growth and prosperity of the Company and motivates them to demonstrate appropriate behaviours across all areas of the business.

Executives are also aligned with shareholders through the LTIP, which pays out in shares based on performance against Group financial targets over a three year period. The Committee believes that the performance measures for the 2014 LTIP award for the Executive Committee should incorporate core financial measures alongside strategic non-financial measures to fulfil the Company's operating plan. These measures capture risk management, profit growth and shareholder experience and align shareholder experience and management reward.

Long-term incentive performance measures

During 2013, the Committee has consulted widely with shareholders on the topic of performance measures and sharing the growth in the Company appropriately between shareholders and management. In addition to the financial measures of Economic Profit, Total Shareholder Return and Cost:Income ratio, the performance conditions for the 2014 LTIP will comprise measures linked to the Group's strategic targets that reflect the wider Group objectives. These measures are customer satisfaction, net promoter score, SME book and first time buyer book.

Category	Measure	Basis of payout range	Metric	Weighting
Financial	Economic Profit	Set relative to 2016 targets	Threshold: £2,154m Maximum: £3,231m	30%
	Absolute TSR	Growth in share price including dividends over 3 year period	Threshold: 8% pa Maximum: 16% pa	30%
	Cost:Income ratio	Set relative to 2016 targets	Threshold: 48.9% Maximum: 46.5%	10%
Customer	Customer satisfaction (Total FCA reportable complaints per 1,000 accounts) [1]	Set relative to 2016 targets	Threshold: 1.15 Maximum: 1.05	10%
	Net promoter score	Major Group average ranking over 2016	Threshold: 3rd Maximum: 1st	10%
Helping Britain Prosper	SME lending	Set relative to targets for SME lending growth over 3 year period	Threshold: 14% Maximum: 18%	5%
	Share of first-time buyer market	Set relative to targets for market share over 3 year period	Threshold: 20% Maximum: 25%	5%

Notes

[1] Measure excludes PPI complaints, but includes Banking, Home Finance, General Insurance, Life, Pensions and Investment complaints.

Governance and Risk Management

An essential component of the approach to remuneration is the governance process that underpins it. This ensures that the policy is robustly applied and risk is managed appropriately.

In addition to setting the overall remuneration policy and philosophy for the Group, a key role for the Committee is to ensure that colleagues who could have a material impact on the Group's risk profile are provided with appropriate incentives and reward to encourage them to enhance the performance of the Group and that they are recognised for their individual contribution to the success of the organisation, whilst ensuring that there is no reward for excessive risk taking. The Committee works closely with the Risk Committee in ensuring the bonus pool is moderated. The two Committees meet every year to determine whether the proposed bonus pool and performance assessments adequately reflect the risk appetite and framework of the Group; whether it took account of current and future risks; and whether any further adjustment is required or merited. The Group and the Remuneration Committee are determined to ensure that the aggregate of the variable remuneration for all colleagues is appropriate and balanced with the interests of shareholders and all other stakeholders.

The Remuneration Committee's terms of reference are available from the Company Secretary and are displayed on the Group's website, www.lloydsbankinggroup.com. These terms were last updated in April 2012 and have subsequently been reviewed in 2013 to ensure continued compliance with the Remuneration Code.

❖ Further details on directors' remuneration can be found in the Directors' Remuneration Report located on pages 100 to 122 of the 2013 Lloyds Banking Group plc Annual Report and Accounts.

APPENDIX 5

GLOSSARY

GLOSSARY

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. Such a customer is also said to be in a state of delinquency and the entire outstanding balance is delinquent.

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

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.

Backtesting — Application of an analytical method where historical data is used to determine how accurately the model has predicted actual results.

Basel II — The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel 2.5 — The 2009 update to the Basel II framework to strengthen market risk and securitisation capital requirements and to enhance disclosure in these areas. See also **CRD III**.

Basel III — The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and due to be phased in, through CRD IV, from 1 January 2014 onward.

Basel III Leverage Ratio — A capital leverage measure, introduced under the Basel III reforms, that is defined as the ratio of tier 1 capital to total exposures, where total exposures equal the sum of all balance sheet assets and off-balance sheet items not deducted in determining tier 1 capital. The leverage ratio is intended to reinforce risk based capital requirements with a simple, non-risk based 'backstop' measure.

Basis point — One hundredth of a per cent (0.01 per cent). 100 basis points is 1 per cent. Used in quoting movements in interest rates or yields on securities.

BIPRU — The prudential sourcebook for Banks, Building Societies and Investment Firms in force at 31 December 2013.

Buy-to-let mortgages — Buy-to-let mortgages are those mortgages offered to customers purchasing residential property as a retail investment.

Capital resources — Eligible capital held by the Group in order to satisfy its capital requirements.

Central Counterparty (CCP) — An institution mediating between the buyer and the seller in a financial transaction, such as a derivative contract or repurchase agreement (repo). Where a CCP is used, a single bilateral contract between the buyer and the seller is replaced with two contracts, one between the buyer and the CCP and one between the CCP seller.

Collateralised Debt Obligations (CDO) — A security issued by a third party which references ABSs or other assets purchased by the issuer. Lloyds Banking Group has invested in instruments issued by other banking groups, including Collateralised Loan Obligations and Commercial Real Estate CDOs.

Collateralised Loan Obligations (CLO) — A security backed by the repayments from a pool of commercial loans. CLOs are usually structured products with different tranches whereby senior classes of holder receive repayment before other tranches are repaid.

Collectively assessed loan impairment provision — A provision established following an impairment assessment on a collective basis for homogeneous groups of loans, such as credit card receivables and personal loans, that are not considered individually significant and for loan losses that have been incurred but not separately identified at the balance sheet date.

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 mortgage repayments of interest and 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, medical centres, hotels, malls, retail stores, shopping centres, farm land, multifamily housing buildings, warehouses, garages, and industrial properties.

Common equity tier 1 (CET1) capital — The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.

Conduits — A financial vehicle that holds asset backed securities which are financed with short-term deposits (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.

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.

Core tier 1 capital	As defined by the PRA mainly comprising shareholders' equity and equity non-controlling interests after deducting goodwill, other intangible assets and other regulatory deductions.
Core tier 1 ratio	Core tier 1 capital as a percentage of risk weighted assets.
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.
CRD III	Implemented on 31 December 2012 through an EU directive, CRD III strengthened the capital requirements for the trading book, imposed higher capital requirements for re-securitisations, required enhanced public disclosures under Pillar 3 of the capital framework and updated disclosure standards for market risk and securitisations.
CRD IV	In June 2013, the European Commission published legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which form the CRD IV package. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules are implemented in the UK via the PRA policy statement PS7/13 and are in force from 1 January 2014, with certain sections subject to transitional phase in.
Credit quality step	A step in the PRA's credit quality assessment scale which is based on the credit ratings applied by ECAIs. The scale is used to assign risk weights to exposures under the Standardised Approach.
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 a type of 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. The entity selling protection 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 derivatives	A credit derivative is a financial instrument that derives its value from the credit rating of an underlying instrument carrying the credit risk of the issuing entity. The principal type of credit derivatives are credit default swaps, which are used by the Group as part of its trading activity and to manage its own exposure to credit risk.
Credit risk	The risk that parties with whom the Group has contracted fail to meet their obligations (both on and off-balance sheet).
Credit risk mitigation	A technique used to reduce the credit risk associated with an exposure (which continues to be held) by application of credit risk mitigants such as collateral, guarantees and credit protection.
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.
Credit Valuation Adjustments (CVA)	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Debit Valuation Adjustment (DVA)	An adjustment to the measurement of derivative liabilities to reflect default risk of the entity.
Debt restructuring	This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as reducing the debt or interest charged on the loan.
Debt securities	Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	These are unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Embedded equity conversion feature	An embedded equity conversion feature is a derivative contained within the terms and conditions of a debt instrument that enables or requires the instrument to be converted into equity under a particular set of circumstances. The Group's Enhanced Capital Notes (ECNs) contain such a feature whereby these notes convert to ordinary shares in the event that the consolidated core tier 1 ratio of the Group falls below 5 per cent.
Enhanced Capital Notes (ECNs)	The Group's ECNs are subordinated notes issued by the Group that contain an embedded equity conversion feature.
Equity risk	The financial risk involved in holding equity in a particular investment.
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	An asset, off-balance sheet item or position which carries a risk of financial loss.
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 (i.e. eligible financial collateral). 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.
Fair value adjustment	Fair value adjustments arise on acquisition when assets and liabilities are acquired at fair values that are different from the carrying values in the acquired company. In respect of the Group's acquisition of HBOS the principal adjustments were write-downs in respect of loans and advances to customers and debt issued.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan in response to an obligor's financial difficulties.
Foundation Internal Ratings Based (Foundation IRB) Approach	Application of the Foundation Internal Ratings Based (Foundation IRB) 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 under the Foundation IRB Approach are determined in accordance with standard parameters set by the regulator rather than on the basis of internal estimates. The Foundation IRB Approach cannot be applied to retail portfolios.
GENPRU	The General Prudential sourcebook in force at 31 December 2013.
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.
Hybrid capital securities	Under CRD II, forms of capital securities that are ineligible for inclusion within core tier 1 capital may be included in non-core tier 1 capital if they qualify to be recognised as hybrid capital securities. Such securities must display a greater degree of permanence and loss absorbency than other subordinated liabilities, have flexibility surrounding coupon or dividend payments and include the ability to write down or to convert into ordinary shares upon a trigger event.
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 charge and impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of an impairment charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Impairment losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the asset's value is lower than it's carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate.
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.
Individually assessed loan impairment provisions	Impairment loss provisions for individually significant impaired loans are assessed on a case-by-case basis, taking into account the financial condition of the counterparty, any guarantor and the realisable value of any collateral held.
Interest rate risk (IRR)	Interest rate risk in arises from the different repricing characteristics of the Group's non-trading assets, liabilities and off-balance sheet positions of the Group. Interest rate risk arises predominantly from the mismatch between interest rate sensitive assets and liabilities, but also to the investment term of capital and reserves, and the need to minimise income volatility.
Internal Assessment Approach (IAA)	The Internal Assessment Approach is an IRB approach for securitisations whereby a firm applies its internal assessment of the credit quality of the positions in the risk weighted asset calculations. A firm must apply to the PRA for permission to use this approach and must satisfy the PRA of its internal assessment processes. The Internal Assessment Approach may only be applied to exposures arising from asset backed commercial paper programmes.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, based on Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.
Internal Model Method (IMM)	The Internal Model Method is one of three methods available to calculate exposure values for counterparty credit risk. A firm must only apply the IMM if it has counterparty credit risk IMM permission from the PRA.
Investment grade	This refers to the highest range of credit ratings, from 'AAA' to 'BBB' as measured by external credit rating agencies.
International Swaps and Derivatives Association (ISDA) master agreement	A standardised contract developed by the ISDA which is used as an umbrella contract for bilateral derivative contracts.
Leverage Ratio	Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure.
Loan-to-Value Ratio (LTV)	The loan-to-value ratio is a mathematical calculation which expresses the amount of a mortgage balance outstanding as a percentage of the total appraised value of the property. A high LTV indicates that there is less value to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance of the loan.
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. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.
Mark-to-Market (MTM) Approach	The Mark-to-Market Approach is one of three methods available to calculate exposure values for counterparty credit risk. The method adjusts daily to account for profits and losses in the value of related assets and liabilities.
Market risk	The risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and bond prices, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and / or value.
Master netting agreement	An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.
Minimum capital requirement	The minimum regulatory capital that must be held in accordance with Pillar 1 requirements for credit, market and operational risk.
Model validation	The process of assessing and providing evidence that the bank's models perform as planned and adequately reflect the risk profile of the business, and that there are no material misstatements of the capital requirement. See also **Backtesting**.
Mortgage related assets	Assets which are referenced to underlying mortgages.
Multilateral Development Banks	Institutions created by groups of countries to provide finance and professional advice for development.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
Over-the-Counter (OTC) derivatives	Over the counter derivatives are derivatives for which the terms and conditions can be freely negotiated by the counterparties involved, unlike exchange traded derivatives which have standardised terms.
Past due items	An exposure class under the Standardised Approach that recognises exposures that are more than 90 days past due.
Pillar 1	The first pillar of the Basel II framework sets out the minimum regulatory capital requirements for credit, operational and market risks.
Pillar 2	The second pillar of the Basel II framework is known as the Supervisory Review Process, and sets out the review process for a banks capital adequacy; the process under which the supervisors evaluate how well financial institutions are assessing their risks and the actions taken as a result of these assessments.
Pillar 3	The third pillar of the Basel II framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.
Potential Future Exposure (PFE)	A regulatory add-on for the potential future credit exposure on derivatives contracts as calculated under the Mark-to-Market Approach.
Prime mortgages	Prime mortgages are those granted to the most creditworthy category of borrower.
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.
Prudent Valuation Adjustment (PVA)	A regulatory deduction applied to CRD IV common equity tier 1 capital based upon the difference between the prudent value of trading book assets or other financial assets measured at fair value with the fair values recognised for these assets in the financial statements.
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 on their obligation 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.
Ratings Based Approach (RBA)	The Ratings Based Approach is an IRB approach for securitisations applied to rated securitisation and re-securitisation positions. The approach applies risk weightings to positions based on a combination of ECAI ratings, the granularity of the underlying pool, the seniority of the position and whether the position is a re-securitisation position.
Regulatory capital	The amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.
Re-securitisations	A securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position.
Renegotiated loans	Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. In the latter case renegotiation can

result in an extension of the due date of payment or repayment plans under which the Group offers a concessionary rate of interest to genuinely distressed borrowers. This will result in the asset continuing to be overdue and will be impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset. In other cases, renegotiation will lead to a new agreement, which is treated as a new loan.

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.

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).

Residual maturity
The length of time remaining from present date until the maturity of the exposure.

Retail Internal Ratings Based (Retail IRB) Approach
The Retail Internal Ratings Based (Retail IRB) Approach allows internal estimates of PD, LGD and EAD to be used in determining credit risk capital requirements for retail portfolios.

Retail loans
Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as mortgages and credit card balances.

Risk appetite
The amount and type of risk that the Group is prepared to seek, accept or tolerate.

Risk weighted assets (RWAs)
A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with PRA rules.

Securities financing transactions (SFTs)
Securities financing transactions are repurchase and reverse repurchase agreements, buy / sell backs and securities lending. For the lender (seller) of the securities it is usually a way to raise funds to finance the securities positions. For the borrower (buyer) of the securities it is a way to invest short–term funds or to cover short (bond) positions.

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 structured 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.

Securitisation position
A retained or purchased position (exposure) in the securities issued by a securitisation.

Sovereign exposures
Exposures to central governments and central government departments, central banks and entities owned or guaranteed by the aforementioned.

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.

Structured entities (SEs)
SEs are entities that have been designed so that voting or similar rights are not the dominant factor in determining who controls the entity, such as which voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs often have specific restrictions around their ongoing activities and are created to accomplish a narrow and well-defined objective.

Stressed VaR (SVaR)
Stressed VaR is a one year forward looking measure of VaR where certain parameters of the portfolio are calculated under a period of stress.

Stress testing
Stress and scenario testing is the term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital resources which are required to be held.

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.

Synthetic CDO
A security that is similar in structure to a CDO whereby the pool of referenced assets is created synthetically usually by credit default swaps.

The Standardised Approach (TSA)
A standardised measure for calculating operational risk capital requirements based on the three year average of the aggregate risk weighted relevant indicators of the underlying business. The relevant indicators are derived from total income.

Through-the-cycle (TTC)
See **Point-in-time (PIT)**

Tier 1 capital
A measure of a bank's financial strength defined by the PRA. It captures core tier 1 capital plus other tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.

Tier 1 capital ratio
Tier 1 capital as a percentage of risk weighted assets.

Tier 2 capital
A component of regulatory capital defined by the PRA, mainly comprising qualifying subordinated loan capital, certain non-controlling interests and eligible collective impairment allowances.

Trading book	Positions in financial instruments and commodities held for trading purposes or to hedge other elements of the trading book.
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. It is measured to specified level of confidence, often 95 per cent or 99 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.
Write-off	The reduction of the value of an asset to zero, reflecting the inability to recover any residual value.
Wrong way risk	The risk that arises from the correlation between a counterparty exposure and the credit quality of the counterparty. It is therefore the risk that the probability of default of the counterparty increases with the exposure.

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