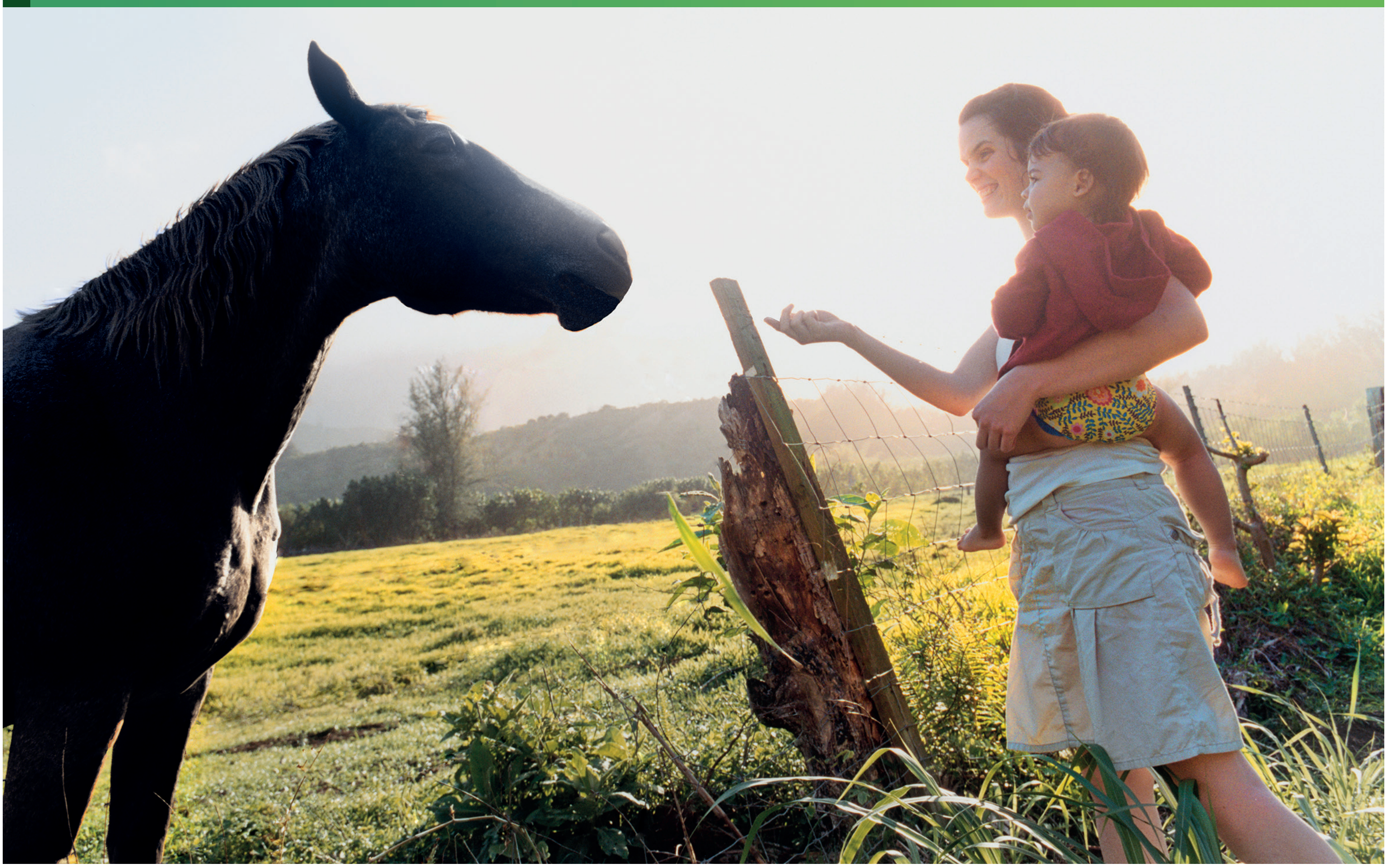
BECOMING THE BEST BANK FOR CUSTOMERS

Lloyds Banking Group
Capital and Risk Management Pillar 3 Report

2014



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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 and risks to cyber security; natural and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes, people and systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, 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 including the implementation of key legislation and regulation; 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; actions or omissions by the Group's directors, management or employees including industrial action; changes to the Group's post-retirement defined benefit scheme obligations; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EU State Aid obligations; the provision of banking operations services to TSB Banking Group plc; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; market related trends and developments; exposure to regulatory or competition scrutiny, legal proceedings, regulatory or competition 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.

Summary analysis

Common equity tier 1 ratio (CET1) (2013: 10.3%)[1] **12.8%**	Transitional tier 1 capital ratio (2013: 11.7%)[1] **16.5%**	Transitional total capital ratio (2013: 18.8%)[1] **22.0%**
Leverage ratio (2013: 3.8%)[2] **4.9%**	Total risk-weighted assets (2013: £271.9bn)[1] **£239.7bn**	Expected losses (2013: £14.3bn) **£6.5bn**

[1] 31 December 2013 comparatives reflect Capital Requirements Directive and Regulation (CRD IV) rules as at 1 January 2014, as implemented by the Prudential Regulatory Authority (PRA), and are reported on a pro forma basis that includes the benefit of the sales of Heidelberger Leben, Scottish Widows Investment Partnership and the Group's 50 per cent stake in Sainsbury's Bank.

[2] Calculated in accordance with the January 2014 revised Basel III leverage ratio framework and reported on a pro forma basis that includes the benefit of the sale of Heidelberger Leben, Scottish Widows Investment Partnership and the Group's 50 per cent stake in Sainsbury's Bank.

COMMON EQUITY TIER 1

SUMMARY ANALYSIS

COMMENTARY

The combination of strong underlying profitability and continued reduction in risk-weighted assets resulted in a further improvement in the Group's CET1 ratio to 12.8 per cent at 31 December 2014 (31 December 2013: 10.3 per cent pro forma).

LEVERAGE RATIO

COMMENTARY

The 1.1 per cent increase in the Group's leverage ratio from December 2013 predominantly reflects the increase in the Group's tier 1 capital position over the period, including the issuance of £5.3bn of CRD IV compliant Additional Tier 1 capital (AT1) instruments, and the growth in CET1 capital.

Risk-weighted assets as at 31 December 2014 amounted to £239.7bn (2013: £271.1bn). A summary breakdown of total risk-weighted assets by risk type and by division is provided in the tables below.

SUMMARY OF RISK-WEIGHTED ASSETS

	Transitional[2]		Prevailing[3]
Risk type	**2014 Risk-weighted assets £m**	2013 Risk-weighted assets £m	2013 Risk-weighted assets £m
Foundation Internal Ratings Based (IRB) Approach[1]	**72,393**	84,882	82,870
Retail IRB Approach	**72,886**	83,815	85,139
Other IRB Approach	**15,324**	9,526	9,221
IRB Approach	**160,603**	178,223	177,230
Standardised Approach	**25,444**	33,819	41,150
Contributions to the default fund of a central counterparty	**515**	484	–
Credit risk	**186,562**	212,526	218,380
Counterparty credit risk	**9,108**	7,546	7,794
Credit valuation adjustment	**2,215**	3,190	–
Market risk	**4,746**	11,082	11,082
Operational risk	**26,279**	26,594	26,594
Underlying risk-weighted assets	**228,910**	260,938	263,850
Threshold risk-weighted assets[4]	**10,824**	11,154	–
Total risk-weighted assets	**239,734**	272,092	263,850
Movement to fully loaded risk-weighted assets[5]	**–**	(1,014)	–
Fully loaded risk-weighted assets	**239,734**	271,078	263,850
Pro forma fully loaded risk-weighted assets	**–**	271,908	–

[1] Includes £15.8bn (2013: £20.5bn) related to corporate specialised lending exposures that are risk weighted on a slotting approach. For the purposes of the more granular Pillar 3 Report, these exposures are reported in other IRB.

[2] CRD IV rules as implemented by the PRA as at 1 January 2014.

[3] The 2013 comparatives within the remainder of this document are based on rules prevailing at 31 December 2013.

[4] Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of deducted from common equity tier 1 capital under threshold rules. Significant investments primarily arise from investment in the Group's Insurance business.

[5] Differences may arise between transitional rules and fully loaded threshold risk-weighted assets where deferred tax assets reliant on future profitability and arising from temporary timing differences and significant investments exceed the fully loaded threshold limit, resulting in an increase in amounts deducted from CET1 rather than being risk-weighted. At 31 December 2014 the fully loaded threshold was not exceeded and therefore no further adjustment was applied to the transitional threshold risk-weighted assets.

RISK-WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

RISK-WEIGHTED ASSET MOVEMENT BY KEY DRIVER

	Credit risk[3] £m	Counterparty credit risk[3] £m	Market risk £m	Operational risk £m	Total £m
Risk-weighted assets as at 31 December 2013[1]	**212,526**	**10,736**	**11,082**	**26,594**	**260,938**
Management of the balance sheet	**(4,694)**	**(366)**	**(1,850)**	**–**	**(6,910)**
Disposals	**(9,781)**	**(170)**	**–**	**–**	**(9,951)**
External economic factors	**(10,459)**	**1,187**	**26**	**–**	**(9,246)**
Model and methodology changes	**(995)**	**(64)**	**(4,512)**	**–**	**(5,571)**
Other	**(35)**	**–**	**–**	**(315)**	**(350)**
Risk-weighted assets	**186,562**	**11,323**	**4,746**	**26,279**	**228,910**
Threshold risk-weighted assets[2]					**10,824**
Total risk-weighted assets at 31 December 2014					**239,734**

[1] 31 December 2013 comparatives reflect CRD IV rules as at 1 January 2014, as implemented by the PRA.

[2] Threshold risk-weighted assets reflect the element of significant investment and deferred tax assets that are permitted to be risk-weighted instead of deducted from CET1 capital under threshold rules. Significant investments primarily arise from investment in the Group's Insurance business.

[3] Credit risk includes movements in contributions to the default fund of central counterparties and counterparty credit risk includes the movements in credit valuation adjustments.

Key Movements

- **Management of the balance sheet** – Risk-weighted assets decreased £6.9bn primarily in Commercial Banking due to active portfolio management and management of market risk positions, partially offset by business growth in Consumer Finance and equities received in consideration for the disposal of Scottish Widows Investment Partnership within Central Items.
- **Disposals** – Disposals reduced risk-weighted assets by £10.0bn, primarily in the Run-off portfolio, including the sale of loans in the Irish retail mortgage portfolio as well as exiting the joint venture banking operations with Sainsbury's, in Retail.
- **External economic factors** – The reduction in risk-weighted assets of £9.2bn is mainly due to positive macroeconomic factors including favourable movements in UK house prices and reduced unemployment which have led to improvements in the credit risk profile of customers.
- **Model and methodology changes** – Model and methodology changes reduced risk-weighted assets by £5.6bn, primarily due to the removal of a temporary capital buffer applied to the Group's internal market risk models on completion of specific market risk infrastructure projects.

SUMMARY DIVISIONAL ANALYSIS OF RISK-WEIGHTED ASSETS

	Transitional		Prevailing
Division	**2014 Risk-weighted assets £m**	2013 Risk-weighted assets £m	2013 Risk-weighted assets £m
Retail	**67,666**	72,948	73,063
Consumer Finance	**20,882**	20,136	20,136
Commercial Banking	**106,185**	123,951	120,843
Central Items	**12,193**	7,743	13,316
TSB[1]	**5,170**	5,591	5,800
Run-off	**16,814**	30,569	30,692
Underlying risk-weighted assets	**228,910**	260,938	263,850
Threshold risk-weighted assets	**10,824**	11,154	–
Total risk-weighted assets	**239,734**	272,092	263,850
Movement to fully loaded risk-weighted assets	**–**	(1,014)	–
Fully loaded risk-weighted assets	**239,734**	271,078	263,850

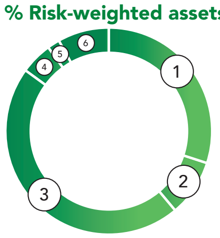
[1] TSB risk-weighted assets are on a Lloyds Banking Group reporting basis and differ to those reported by TSB as a standalone regulated entity.

SPLIT OF RISK-WEIGHTED ASSETS

% Risk-weighted assets by risk type

1. Credit risk (IRB) 70%	(2013: 68%)
2. Credit risk (Std) 11%	(2013: 13%)
3. CCR 4%	(2013: 3%)
4. Market risk 2%	(2013: 4%)
5. Operational risk 11%	(2013: 10%)
6. Other 2%	(2013: 2%)

% Risk-weighted assets by division



1. Retail 30%	(2013: 28%)
2. Consumer Finance 9%	(2013: 8%)
3. Commercial Banking 46%	(2013: 47%)
4. Central Items 5%	(2013: 3%)
5. TSB 2%	(2013: 2%)
6. Run-off 8%	(2013: 12%)

Key movements

- Retail risk-weighted assets reduced by £5.2bn in the year primarily due to improvements in credit quality arising from active portfolio management and the impact of positive economic factors (including favourable movements in UK house prices and reduced unemployment), as well as the exit from its joint venture banking operations with Sainsbury's. These movements are partially offset by risk-weighted asset increases arising from model changes.
- Consumer Finance division risk-weighted assets increased by £0.8bn largely due to new business lending and model changes partially offset by reductions arising from improvements in credit quality and economic factors.
- Commercial Banking risk-weighted assets reduced by £17.8bn mainly reflecting market risk reductions, active portfolio management and methodology refinements. The market risk risk-weighted asset reduction of £6.3bn is primarily due to the removal of a temporary capital buffer applied to the Group's internal market risk models on completion of specific market risk infrastructure projects.
- Central Items risk-weighted assets primarily comprise of the Group's liquidity portfolio and strategic equity investments and other balance sheet assets such as fixed assets and sundry debtors. The increase in the year of £4.4bn is primarily due to equity received in consideration for the disposal of Scottish Widows Investment Partnership (SWIP).
- The reduction in Run-off risk-weighted assets of £13.8bn is mainly due to disposals, including the sale of loans in the Irish retail mortgage portfolio and movements in external economic factors.

Summary analysis continued

CREDIT RISK EXPOSURES

Total credit risk exposures (excluding thresholds) as at 31 December 2014 amounted to £700.2bn (2013: £724.9bn) on an exposure at default (EAD) basis, as defined on page 6. This comprises £580.1bn of exposures risk-weighted under the IRB Approach (2013: £592.5bn) and £120.0bn of exposures risk-weighted under the Standardised Approach (2013: £132.5bn). A summary analysis of credit risk exposures is provided in the table below.

SUMMARY OF CREDIT RISK EXPOSURES

Exposure category	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Risk-weighted assets £m	2013 Average risk weight %
Corporates	116,906	69,198	59%	136,597	79,952	59%
of which: corporate main	80,496	43,735	54%	88,805	48,771	55%
of which: corporate SME	13,979	9,637	69%	14,450	10,570	73%
of which: corporate specialised lending	22,431	15,826	71%	33,342	20,611	62%
Central governments and central banks	15,714	1,618	10%	15,063	1,579	10%
Institutions	7,970	1,577	20%	5,318	1,339	25%
Retail	412,948	72,886	18%	418,696	85,139	20%
of which: residential mortgages (SME)	11,114	3,174	29%	11,151	4,493	40%
of which: residential mortgages (non-SME)	348,212	39,949	11%	352,938	48,020	14%
of which: qualifying revolving retail exposures	36,287	14,061	39%	38,352	16,355	43%
of which: other SME	2,736	1,982	72%	2,864	2,600	91%
of which: other non-SME	14,599	13,720	94%	13,391	13,671	102%
Equities	3,750	7,904	211%	2,934	5,902	201%
Securitisation positions	14,351	2,373	17%	13,860	3,319	24%
Non-credit obligation assets	8,441	5,047	60%	–	–	–
Total – IRB approach	580,080	160,603	28%	592,468	177,230	30%
Central governments and central banks	83,617	11	–	78,523	49	–
Institutions	205	53	26%	948	295	31%
Corporates	15,490	13,646	88%	18,354	16,974	92%
Retail	4,316	2,946	68%	5,325	4,023	76%
Secured by mortgages on immovable property	9,575	3,408	36%	7,289	2,741	38%
Other[1]	6,753	5,380	80%	22,034	17,068	77%
Total – standardised approach	119,956	25,444	21%	132,473	41,150	31%
Contributions to the default fund of a central counterparty	143	515	360%	–	–	–
Total credit risk	700,179	186,562	27%	724,941	218,380	30%
Threshold – significant investments	3,324	8,309	250%	–	–	–
Threshold – deferred tax	1,006	2,515	250%	–	–	–
Total	704,509	197,386	28%	724,941	218,380	30%

[1] Other exposures include exposures to regional governments and local authorities, public sector entities, exposures in default, exposures associated with particularly high risk, short term claims on institutions and corporates, collective investment undertakings and other items.

Key movements

- IRB Corporate Main exposures reduced during the year by £8.3bn primarily driven by asset reductions in Run-off and balance sheet management in core book.
- IRB Corporate specialised lending exposures reduced during the year by £10.9bn primarily driven by disposals and other reductions in the Run-off portfolio. The average risk-weight increased from 62% to 71% driven by exposure reductions in the defaulted category which carries a 0% risk weight.
- Retail IRB residential mortgage exposures decreased by £4.8bn mainly due to the requirement for certain TSB exposures to be reported on the standardised approach and the sale of loans in the Irish mortgage portfolio, partially offset by increased lending in the core book.
- Other standardised exposures reduced significantly in the year, primarily as a result of the implementation of CRD IV, resulting in the replacement of risk-weighted assets associated with deferred tax assets with a deduction from CET1 capital and the reclassification of certain non-credit obligation assets to the IRB approach.
- The average risk weight on IRB Approach exposures has reduced from 30 per cent to 28 per cent primarily driven by improvements in credit quality in the Retail IRB Residential mortgage portfolio.

A detailed analysis of the key movements in exposures and risk-weighted assets is provided on pages 53 to 56.

Introduction

This document presents the consolidated Pillar 3 disclosures of Lloyds Banking Group plc ('the Group') as at 31 December 2014.

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

Pillar 3 requirements under CRD IV are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. The Group's 2014 year end disclosures comply with the requirements and associated guidelines and European Banking Authority (EBA) technical standards in force at 31 December 2014.

The implementation of CRD IV is subject to transitional arrangements, with the full implementation date being 1 January 2022. Consequently, the Group's capital position is shown both by applying the 2014 CRD IV transitional arrangements, as implemented in the UK by PRA policy statement PS7/13 (PRA transitional rules), and also by applying the end-point CRD IV rules (the 'fully loaded' basis).

The main changes to the presentation of the Group's 2014 Pillar 3 disclosures as a result of the implementation of the additional requirements under CRD IV are as follows:

- Declaration on the adequacy of risk management arrangements
- Explanation of the new regulatory capital buffer framework which is being phased in
- Alignment to Basel exposure classes, including additional granularity for small and medium enterprises (SME) exposures
- Additional disclosures around geographical analysis of Loss Given Default (LGD) and Probability of Default (PD) by exposure class
- Additional disclosures around significant subsidiaries (see Appendices 2 and 3)
- Full reconciliation of own funds items to the audited financial statements (see Appendix 1)
- Description of the main features of capital instruments issued by the Group (disclosed separately on the Group's website)
- Encumbered and unencumbered asset disclosures (see Appendix 4)

A statement from the Board is included within the Governance section of the Annual Report and Accounts (page 72) that describes the Group's risk management arrangements as being sufficiently adequate with regard to the Group's profile and strategy in accordance with the requirement of Article 435(e) of the Capital Requirements Regulation. It states that the Audit Committee, in conjunction with the Board Risk Committee, concluded that the Group's risk management systems and internal controls were effective and adequate having regard to the Group's risk profile and strategy, and recommended that the Board approve them accordingly. A risk statement approved by the management body is included within the Risk Overview section of the Annual Report and Accounts (pages 30-33) in accordance with the requirements of Article 435(f) of the Capital Requirements Regulation.

Although the Group is not currently classified as a Global Systemically Important Bank (G-SIB), by virtue of the leverage exposure exceeding €200bn, the Group is required to report G-SIB metrics to the PRA. The Group's metrics used within the 2013 Basel G-SIB exercise were published in July 2014, with the 2014 metrics due to be published in April 2015.

During the course of 2014 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.

In further developing the Pillar 3 disclosures, the Group has continued to build upon the recommendations of the Enhanced Disclosure Task Force (EDTF) and included the following in the 2014 disclosures:

- Enhanced disclosures in relation to the reconciliation of regulatory balance sheet assets to credit risk exposures (page 9-12)
- Presentation of risk-weighted assets flow statement analysing credit, counterparty credit, market and operational risk-weighted assets in greater detail (page 26)
- Additional disclosures in relation to credit risk mitigation including a summary table that indicates how the different forms are applied across the Group in the calculation of capital requirements (page 33-37)
- Enhanced market risk disclosures providing further detail on linkages to the balance sheet (pages 103 to 114)

In addition to the changes required under CRD IV, there remain on-going regulatory developments which the Group monitors closely and assesses the potential impacts of. The Group participates in industry consultations by the regulators either directly or through trade bodies such as the BBA. Certain key developments are discussed in the 'Future Regulatory Developments' section on page 16.

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 2014, prepared in accordance with the requirements of Capital Requirements Regulation (CRR) Part 8 (Disclosure by Institutions).

In satisfaction of certain disclosure requirements, reference has been made to the 2014 Lloyds Banking Group plc Annual Report and Accounts. As such, this document should be read in conjunction with the Annual Report and Accounts, as highlighted throughout 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.

The Group's capital position as at 31 December 2014 is presented applying CRD IV transitional arrangements, as implemented in the UK by PRA policy statement PS7/13, and also on a fully loaded CRD IV basis. The minimum Pillar 1 capital requirements referred to in this document are calculated as 8 per cent of aggregated RWAs.

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 7 to 12.

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 (as disclosed in Tables 13 and 14). A summary, noting the definitions applied, is provided below.

Exposure type	Definition applied
Credit risk exposures (excluding securitisation positions)	EAD pre Credit Risk Mitigation (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 (Tables 13 and 14)	Accounting balance, defined in accordance with IFRS

[1] For credit risk exposures risk-weighted under the Standardised Approach, the EAD pre CRM value is stated net of specific credit risk adjustments (SCRAs). SCRAs relating to credit risk exposures risk-weighted under a relevant IRB Approach methodology are netted against expected losses as described on page 50.

FREQUENCY, MEDIA AND LOCATION

In accordance with Pillar 3 disclosure requirements the Group will continue to make available its full consolidated Pillar 3 disclosures on an annual basis. A standalone copy of these disclosures is located on the Lloyds Banking Group plc website (www.lloydsbankinggroup.com/investors/financial-performance/lloyds-banking-group/).

Finalised guidelines issued by the EBA on Pillar 3 disclosure frequency are expected to come into effect by the end of 2015. These will require the Group to disclose certain information on own funds, leverage, credit risk and counterparty credit risk exposures at each reporting date thereafter.

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 Risk and Finance Directors.

RISK PROFILE DISCLOSURE

In accordance with the requirements of CRR Part 8 (Disclosure by Institutions) 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 2014 Lloyds Banking Group plc Annual Report and Accounts:

– Risk overview, pages 30 to 33;

– Emerging risks, page 110;

– Risk drivers, page 116

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, counterparty 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 CRR (Part One, Title II, Chapter 2).

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. 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.

Insurance undertakings are excluded from the calculation of consolidated capital requirements and consolidated capital resources. The Group's investments in insurance undertakings are instead subject to threshold rules under CRD IV that determine the extent to which the investments are deducted from capital with remaining amounts risk-weighted in accordance with the rules. The regulatory consolidation group diagram presented on page 8 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 2014 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 over capital resources are provided on page 162 of the Risk Management section of the 2014 Lloyds Banking Group plc Annual Report and Accounts.

SUBSIDIARY GROUP DISCLOSURES

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 together with analysis of their credit risk exposures, credit risk mitigation and impairments. These disclosures are provided in fulfilment of the significant subsidiary disclosure requirements under CRR Article 13 (Application of disclosure requirements on a consolidated basis).

SOLO CONSOLIDATION

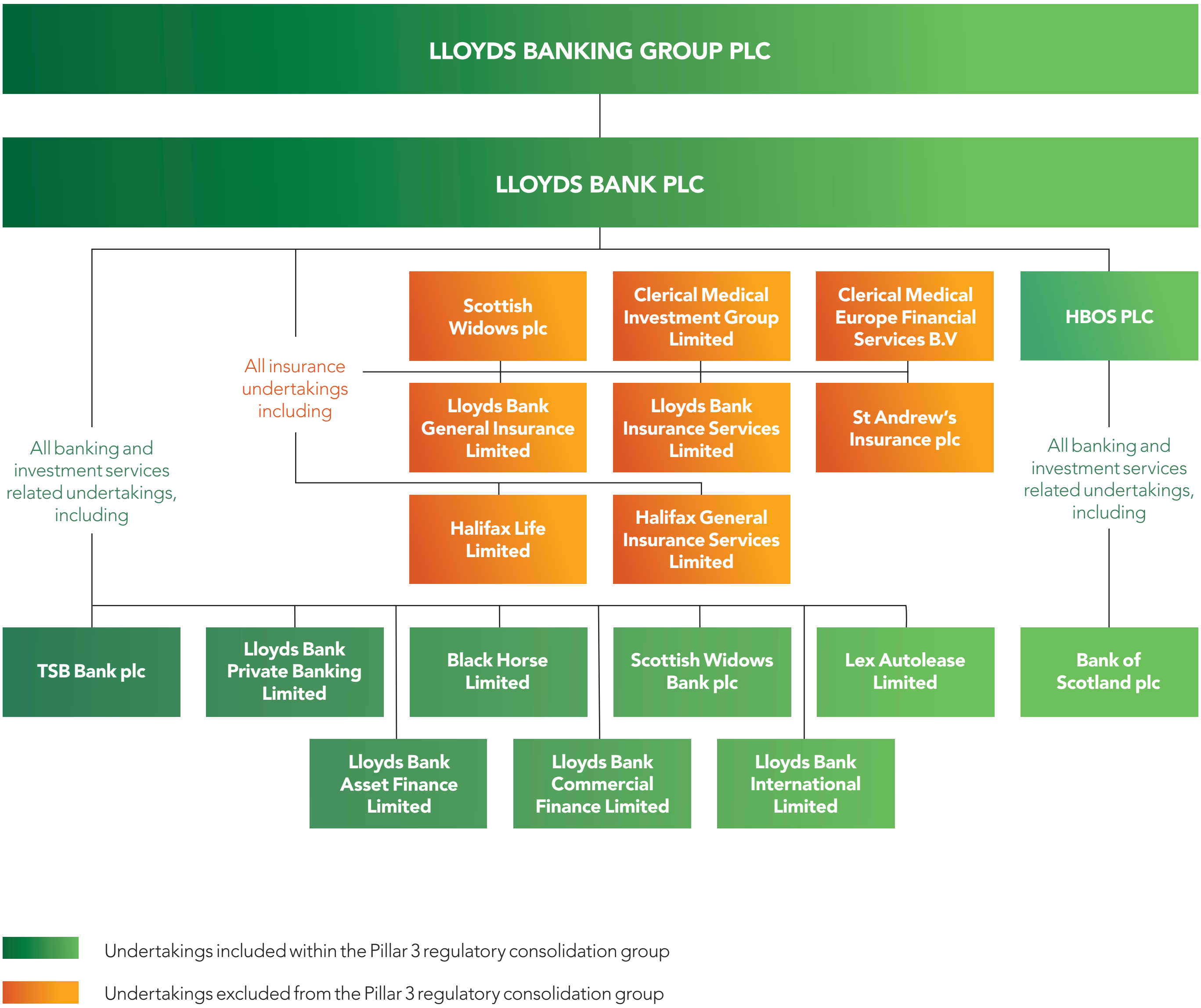
The Group makes use of the solo consolidation provisions set out under CRR (Part One Title II Chapter 1). This allows the capital resources and capital requirements of certain specified subsidiary undertakings of Lloyds Bank plc and Bank of Scotland plc to be included within the respective bank's individual 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.

Scope of consolidation continued

REGULATORY CONSOLIDATION GROUP

A summarised diagrammatical representation (as at 31 December 2014) of the regulatory consolidation group upon which the disclosures presented within this document are based is provided below.



During the course of 2014 the Group completed the disposal of its investment in Sainsbury's Bank plc (a joint venture operation), Scottish Widows Investment Partnership Limited and Heidelberger Lebensversicherung A.G. The Group's remaining insurance undertakings continue to be excluded from the scope of the regulatory consolidation group.

In June and July 2014, the Group sold 38.5 per cent of its holding in TSB via a well-received Initial Public Offering. Together with the subsequent sale of a further 11.5 per cent stake in September 2014 the Group remains firmly on track to meet its European Commission State Aid commitments.

Further details on the key business disposals that completed or that were announced during 2014 are provided on pages 210 and 321 of the 2014 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 182 to 183 of the 2014 Lloyds Banking Group plc Annual Report and Accounts) to the Group's consolidated balance sheet under the regulatory scope of consolidation.

Table 1:
Consolidated regulatory balance sheet

Balance sheet category	Consolidated accounting balance sheet £m	Deconsolidated entities (insurance/ other)[1] £m	Regulatory reallocations[2] £m	Consolidated regulatory balance sheet £m
Assets				
Cash and balances at central banks	50,492	–	–	50,492
Items in the course of collection from banks	1,173	–	(1,173)	–
Trading and other financial assets at fair value through profit or loss	151,931	(91,442)	–	60,489
Derivative financial instruments	36,128	(1,663)	–	34,465
Loans and advances to banks	26,155	(20,746)	–	5,409
Loans and advances to customers	482,704	(6,993)	–	475,711
Debt securities	1,213	(258)	–	955
Available-for-sale financial assets	56,493	2,057	–	58,550
Investment properties	4,492	(4,279)	–	213
Investment in group undertakings	–	5,932	–	5,932
Goodwill	2,016	(1,822)	–	194
Value of in-force business	4,864	(4,864)	–	–
Other intangible assets	2,070	(155)	–	1,915
Tangible fixed assets	8,052	(14)	–	8,038
Current tax recoverable	127	(88)	196	235
Deferred tax assets	4,145	(279)	1,166	5,032
Retirement benefit assets	1,147	(11)	–	1,136
Other assets	21,694	(16,951)	953	5,696
Total assets	854,896	(141,576)	1,142	714,462

Scope of consolidation continued

Balance sheet category	Consolidated accounting balance sheet £m	Deconsolidated entities (insurance/ other)[1] £m	Regulatory reallocations[2] £m	Consolidated regulatory balance sheet £m
Liabilities				
Deposits from banks	10,887	–	(10,887)	–
Customer deposits	447,067	2,383	10,425	459,875
Items in course of transmission to banks	979	–	(979)	–
Trading and other financial liabilities at fair value through profit or loss	62,102	–	–	62,102
Derivative financial instruments	33,187	(1,273)	–	31,914
Notes in circulation	1,129	–	(1,129)	–
Debt securities in issue	76,233	(2,608)	49	73,674
Liabilities arising from insurance contracts and participating investment contracts	86,918	(86,941)	23	–
Liabilities arising from non-participating investment contracts	27,248	(27,248)	–	–
Unallocated surplus within insurance businesses	320	(320)	–	–
Other liabilities	28,105	(20,900)	2,278	9,483
Retirement benefit obligations	453	(7)	–	446
Current and deferred tax liabilities	123	(1,485)	1,362	–
Other provisions	4,200	(228)	–	3,972
Subordinated liabilities	26,042	(2,340)	–	23,702
Total liabilities	804,993	(140,967)	1,142	665,168
Share capital	7,146	–	–	7,146
Share premium account	17,281	–	–	17,281
Other reserves	13,216	(1,077)	–	12,139
Retained profits	5,692	481	–	6,173
Shareholders' equity[3]	43,335	(596)	–	42,739
Other equity instruments	5,355	–	–	5,355
Total equity excluding non-controlling interests	48,690	(596)	–	48,094
Non-controlling interests	1,213	(13)	–	1,200
Total equity	49,903	(609)	–	49,294
Total equity and liabilities	854,896	(141,576)	1,142	714,462

[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.

[2] Regulatory reallocations are made in accordance with regulatory reporting requirements that require certain balances to be re-categorised.

[3] A reconciliation of shareholders' equity to CET1 capital is provided on page 20.

REGULATORY BALANCE SHEET ASSETS TO EXPOSURE AT DEFAULT (EAD)

A reconciliation of consolidated regulatory balance sheet assets to exposure at default (EAD) is presented in the tables below.

Table 2:
Gross drawn credit risk exposure

Regulatory balance sheet category	Consolidated regulatory balance sheet assets £m	Assets deducted from own funds[1] £m	Assets linked to market risk/ counterparty credit risk[2] £m	Other regulatory adjustments[3] £m	Gross drawn credit risk exposures £m
Cash and balances at central banks	50,492	–	–	(206)	50,286
Trading and other financial assets at fair value through profit or loss	60,489	(2,146)	(49,497)	(1,901)	6,945
Derivative financial instruments	34,465	–	(34,465)	–	–
Loans and receivables	482,075	–	(11,258)	2,629	473,446
Available-for-sale financial assets	58,550	–	–	(5,328)	53,222
Investment properties	213	–	–	–	213
Investment in group undertakings	5,932	(5,932)	–	3,324	3,324
Goodwill	194	(194)	–	–	–
Other intangible assets	1,915	(1,915)	–	–	–
Tangible fixed assets	8,038	–	–	–	8,038
Current tax recoverable	235	–	–	–	235
Deferred tax assets	5,032	(5,032)	–	1,006	1,006
Retirement benefit assets	1,136	(1,136)	–	–	–
Other assets	5,696	–	(53)	461	6,104
Total	714,462	(16,355)	(95,273)	(15)	602,819

[1] Assets that are ultimately deducted from own funds, subsequent to regulatory adjustments applied and are therefore not risk-weighted. See table 93 (Reconciliation of own funds items to audited financial statements).

[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 adjustments to reflect specific regulatory treatments and valuation methodologies.

Scope of consolidation continued

Table 3:
Gross drawn credit risk exposure to exposure at default

Regulatory balance sheet category	Gross drawn credit risk exposure £m	Off balance sheet items[1] £m	Specific regulatory adjustments[2] £m	Exposure at default (pre-CRM) £m
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate – main	48,628	32,223	(355)	80,496
Corporate – SME	11,663	2,299	17	13,979
Corporate – specialised lending	11	–	–	11
Central governments and central banks	15,710	–	4	15,714
Institutions	5,886	1,923	161	7,970
Retail IRB Approach				
Retail Mortgages	333,743	9,742	15,841	359,326
of which: residential mortgages (SME)	10,216	809	89	11,114
of which: residential mortgages (non-SME)	323,527	8,933	15,752	348,212
Qualifying revolving retail exposures	11,051	25,223	13	36,287
Other SME	1,895	841	–	2,736
Other non-SME	14,472	27	100	14,599
Other IRB Approaches				
Corporate – specialised lending	20,166	2,170	84	22,420
Equities	3,470	280	–	3,750
Securitisation positions	4,494	9,857	–	14,351
Non-credit obligation assets	8,441	–	–	8,441
Total – IRB Approach	479,630	84,585	15,865	580,080
Exposures subject to the Standardised Approach				
Central governments and central banks	83,346	–	271	83,617
Regional governments or local authorities	–	–	–	–
Public sector entities	9	–	–	9
Multilateral development banks	–	–	–	–
International organisations	–	–	–	–
Institutions	146	59	–	205
Corporates	13,074	2,614	(198)	15,490
Retail	4,266	99	(49)	4,316
Secured by mortgages on immovable property	9,585	10	(20)	9,575
of which: residential property	9,573	10	(20)	9,563
of which: commercial property	12	–	–	12
Exposures in default	2,898	37	(1,596)	1,339
Exposures associated with particularly high risk	1	–	–	1
Short term claims on institutions and corporates	–	–	–	–
Collective investment undertakings ('CIUs')	–	–	–	–
Equity exposures	–	–	–	–
Other items	5,391	13	–	5,404
Total – Standardised Approach	118,716	2,832	(1,592)	119,956
Contribution to default fund of a central counterparty	143	–	–	143
Total credit risk	598,489	87,417	14,273	700,179
Threshold – Significant Investments	3,324	–	–	3,324
Threshold – Deferred Tax	1,006	–	–	1,006
Total	602,819	87,417	14,273	704,509

[1] Off balance sheet items after the application of credit conversion factors captures items that are off balance sheet but within the scope of credit risk calculations. Off balance sheet items primarily consist of undrawn credit facilities, including facilities that may be cancelled unconditionally at any time without notice.

[2] Specific regulatory adjustments applied to Retail IRB exposures primarily represent the uplift from gross exposure to modelled exposure at default. Within standardised asset classes, the reduction primarily reflects the application of specific credit risk adjustments.

The regulatory capital framework

The Group's regulatory capital framework is defined by the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulatory Authority (PRA) policy statement PS7/13.

REGULATORY CAPITAL

The Group's capital resources are classified depending on the degree of permanency and loss absorbency exhibited:

Common equity tier 1 capital (CET1)

This represents the strongest form of capital consisting of shareholders' equity (ordinary share capital and reserves) after a number of regulatory adjustments and deductions are applied. Of these, the most significant for the Group are the deduction of part of the Group's capital within its Insurance business and a large part of the Group's deferred tax assets. Other significant deductions are the elimination of the cash flow hedging reserve and deductions applied for goodwill, other intangible assets and defined benefit pension surpluses.

CET1 capital can be supplemented by certain subordinated debt liabilities and other capital securities classified as Additional Tier 1 (AT1) or Tier 2 capital (T2).

Additional tier 1 capital (AT1)

AT1 capital instruments are non-cumulative perpetual securities containing a specific provision to write down the security or convert it to equity should the CET1 ratio fall to a defined trigger limit. The Group's current AT1 securities contain a trigger limit of 7 per cent.

Under the CRD IV transitional rules, securities that do not qualify in their own right as AT1 but were issued and eligible as tier 1 capital prior to CRD IV can partially be included within AT1, until they are phased out altogether in 2022. To the extent that these securities do not qualify as AT1 they may nevertheless still qualify as tier 2 capital.

Also under the CRD IV transitional rules, a portion of the subordinated debt issued by the Group's Insurance business and held by the Group is deducted from AT1 capital. The remaining portion is deducted from T2 capital.

Tier 2 capital (T2)

T2 capital comprises certain other subordinated debt securities that do not qualify as AT1. They must have an original term of at least 10 years, can not normally be redeemed within their first 5 years and are phased out as T2 regulatory capital in the final 5 years before maturity.

Again, CRD IV transitional rules operate allowing securities that do not qualify in their own right as T2 but which were issued and eligible as T2 capital prior to CRD IV to be partially included as T2 capital, until they are phased out altogether in 2022.

There are two further adjustments: Any excess of IRB loan loss provisions over the corresponding expected losses is added back to T2 capital; and a deduction is made of the part of the subordinated debt issued by the Group's Insurance business that is not deducted from AT1 capital.

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

PILLAR 1 – MINIMUM CAPITAL REQUIREMENTS

Pillar 1 of the regulatory framework focuses on the determination of risk-weighted assets and expected losses in respect of the firm's exposure to credit, counterparty credit, market and operational risks. At 31 December 2014 at least 4 per cent of risk-weighted assets had to be covered by CET1 capital, although this increased to 4.5 per cent from 1 January 2015.

The regulatory minimum amount of total capital is determined as 8 per cent of the aggregate risk-weighted assets and the Pillar 1 capital requirements referenced in this document are calculated using this regulatory minimum value.

A range of approaches, varying in sophistication, are available under the CRD IV framework to use in measuring risk-weighted assets to determine the minimum level of capital required. Within the Group, risk-weighted assets are predominantly calculated using internal models that are prudently calibrated based on internal loss experience and are subject to a number of internal controls and external scrutiny from the PRA. A brief summary of the different approaches for the different risk types and their application by the Group is disclosed in the table below, with further detail provided in each of the sections as indicated.

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 40 and 41 and 106 to 107, respectively.

Expected losses under the IRB approach are calculated by multiplying EAD by PD and LGD, with the exception of the Supervisory Slotting approach where these are prescribed by the regulator.

The regulatory capital framework continued

PILLAR 1 CAPITAL REQUIREMENTS

Risk type	Approaches	Application within the Group
Credit risk	Credit Risk risk-weighted assets represent a measure of on and off balance sheet exposures weighted according to risk as specified under CRD IV, either directly, or derived from a formula. There are two key approaches under CRD IV: **Standardised Approach** This is the most basic approach which applies a standard set of risk weights to exposures. Under this approach banks can utilise external credit ratings to determine risk weights for rated counterparties. **IRB Approach** A prescribed regulatory formula is used to calculate risk-weighted assets which incorporates PD, LGD and EAD in addition to other variables such as maturity and correlation. Under CRD IV there are also adjustments applied to the calculation of risk-weighted assets in respect of an uplift for Financial Institutions Interconnectedness (FII) and a reduction for exposure to SMEs. *Foundation IRB Approach (FIRB)* The FIRB Approach uses internal assessments of a counterparty's PD (subject to certain floors) together with regulatory defined assessments for LGD and EAD. *Advanced IRB Approach (AIRB)* The AIRB Approach uses internal assessments of PD, EAD and LGD (subject to certain floors). *Other Approaches* For certain specialised lending exposures there is also a supervisory slotting approach which assigns regulatory prescribed risk-weighted assets based on the characteristics of each exposure. A number of alternative methodologies exist for other areas such as equity exposures and securitisation positions.	The Group applies the Standardised Approach to a small number of portfolios. These portfolios are mostly portfolios awaiting roll-out under the Group's IRB roll-out plan and portfolios permanently exempt from the IRB. For the Group's commercial portfolios, the FIRB Approach is used for the majority of exposures as the Group does not currently have permission to utilise the AIRB Approach. The Group applies the retail specific AIRB Approach for the vast majority of its retail exposures. The Group applies the Supervisory Slotting Approach to certain corporate specialised lending exposures comprising mainly its commercial real estate exposures. The Simple Risk Weight Method is applied to the Group's equity exposures. Securitisation positions are predominantly risk-weighted under the Ratings Based Approach (RBA), with limited use made of the Internal Assessment Approach (IAA).
Counterparty credit risk	There are three approaches to measuring exposure for counterparty credit risk, as below, which when combined with an appropriate PD and LGD feeds into the relevant IRB approach or alternatively capital requirements are calculated under the Standardised approach. **Standardised Method** The exposure value is calculated by applying a multiplier to the market value, dependent on the type of contract. **Mark-to-Market Method** Under this method, an add-on for potential future exposure is applied to the balance sheet value of the instrument to give the overall exposure. **Internal Models Method ('IMM')** Under the IMM approach, the fair value on the balance sheet is replaced by an exposure value calculated using internal models.	The Group's counterparty credit risk exposures are first measured under the Mark-to-Market Method, prior to being risk weighted under either the FIRB or Standardised Approach.
Market risk	The two key approaches for Market Risk are as follows: **Standardised Approach** This 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. **Internal Models Approach** Following PRA approval, involves the use of internal Value at Risk (VaR) models to determine appropriate capital requirements based on the market risks in the trading book.	The majority of the Group's trading book positions are assigned a capital requirement under the Internal Models Approach with the remainder following the Standardised Approach.
Operational risk	There are 3 approaches for Operational Risk: **Basic Indicator Approach (BIA)** A low risk sensitivity approach which calculates the capital requirement as a percentage of average net interest and non-interest income. **Standardised Approach (TSA)** A medium risk sensitivity approach where the capital requirement is derived from the three year average of the aggregate risk weighted relevant indicators of the underlying business. **Advanced Modelling Approach (AMA)** A high risk sensitivity approach where, following PRA approval, the capital requirement is determined through the use of internal operational risk measurement model.	The Group currently measures its operational risk requirement using TSA.

PILLAR 2 – SUPERVISORY REVIEW PROCESS

The minimum requirement for capital is supplemented by Pillar 2 of the regulatory framework, through Pillar 2A and Pillar 2B.

PILLAR 2A

Under Pillar 2A, additional minimum requirements are set by the PRA by the issuance of bank specific Individual Capital Guidance (ICG) which reflects a point in time estimate by the PRA, which may change over time, of the total amount of capital that is needed by the bank and includes the assessment of risks that are not fully covered by Pillar 1 such as credit concentration and operational risk, and those risks not covered by Pillar 1 such as pensions and interest rate risk. The Group's Pillar 2A ICG equates to 3.8 per cent of RWAs of which 2.1 per cent must be covered by CET1 capital.

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 LBG ICAAP supplements the Pillar 1 capital requirements for credit risk, counterparty credit risk, operational risk and traded market risk 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.

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

PILLAR 2B

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. Under Pillar 2B the PRA uses the outputs from some of these stress analyses to inform the setting of the Group's Capital Planning Buffer (CPB), defining 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 CPB to remain confidential between the Group and the PRA.

Further details on the Group's stress testing processes and the 2014 PRA and EBA stress testing results are included on page 111 of the Annual Report and Accounts.

REGULATORY CAPITAL BUFFERS

In addition to the CPB, the Group could potentially also be required to maintain a countercyclical capital buffer of up to 2.5 per cent. This buffer is time-varying and is designed to require banks to hold additional capital to remove or reduce the build up of systemic risk in times of credit boom, providing additional loss absorbing capacity and acting as an incentive for banks to constrain further credit growth. The calculation of the buffer is based on a weighted average of the countercyclical capital buffer rates that apply in the jurisdictions in which the Group's credit exposures are located. The Financial Policy Committee (FPC) of the Bank of England is responsible for setting the UK countercyclical rate and for recognising rates set by other jurisdictions, or for recommending higher rates. This buffer is currently set at zero for the UK. Rates for Norway and Sweden (at 1 per cent) have been recognised by the FPC and will apply from October 2015. Therefore the Group is not currently required to hold a countercyclical capital buffer and given the Group has minimal exposures to these two countries the requirement will be negligible when it is applied.

The FPC can also set sectoral capital requirements which are temporary increases to banks' capital requirements on exposures to specific sectors, if the FPC judges that exuberant lending to those sectors poses risks to financial stability. No sectoral capital requirements currently apply to the Group.

From 2016, under CRD IV two other CET1 capital buffers will be phased in over the period to 1 January 2019. The capital conservation buffer is a general buffer of 2.5 per cent of risk-weighted assets designed to provide for losses in the event of stress. The systemic risk buffer is an additional buffer of up to 3 per cent of risk-weighted assets for certain banks that are considered to be 'systemically important' either globally (G-SIBs) or domestically (D-SIBs) and, from 2018, for banks that are 'ring-fenced' under the bank resolution framework. The Group is not currently designated a G-SIB bank but may be designated a D-SIB bank.

To recognise these new buffers the PRA intends to rename the CPB as the PRA buffer and when setting the PRA buffer, will take into account the extent to which these CRDIV buffers already capture the risks identified in the PRA buffer assessment. This is depicted in the diagram on page 16.

All buffers are required to be met with CET1 capital. Where the PRA buffer assessment is binding, a breach of the PRA buffer would trigger a dialogue between the bank and the PRA to agree what action is required. Where the capital conservation buffer and systemic risk buffers are binding, a breach of these buffer requirements would give rise to automatic constraints upon any discretionary capital distributions by the bank.

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.

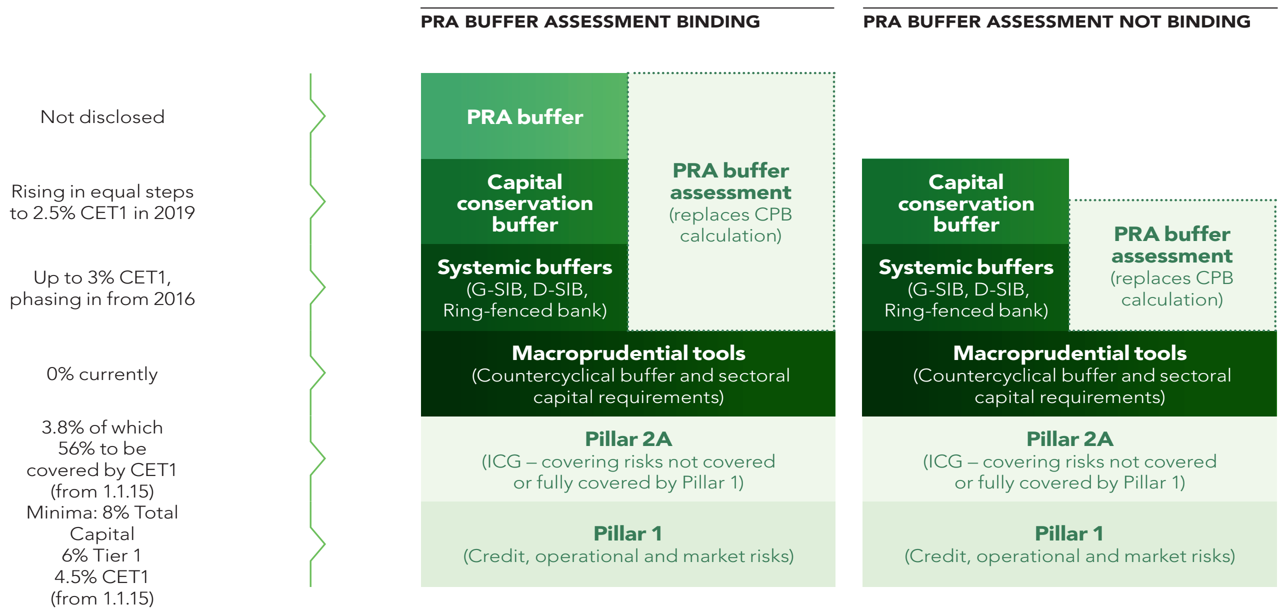
The Basel III framework sets out the minimum disclosures required under Pillar 3. Together with additional minimum disclosure requirements imposed through amendments to the original CRD, these form the basis of the disclosures the Group is required to make under the relevant CRR provisions (Part 8 – Disclosure by institutions).

LEVERAGE FRAMEWORK

In addition to the risk-based capital framework outlined above, the Group is also subject to minimum capital requirements under the leverage ratio framework. The leverage ratio is calculated by dividing tier 1 capital resources by a defined measure of on-balance sheet assets and off-balance sheet items.

In October 2014 the FPC, following a period of consultation with the industry, issued its final proposals regarding the establishment and calibration of a UK leverage ratio framework. The FPC has recommended that major domestic banks should be required to meet a minimum leverage ratio of 3 per cent (in line with current Basel Committee proposals), a supplementary systemic risk based leverage buffer of up to 1.05 per cent (to apply from 2016 for G-SIBs and from 2019 for the Group and other major domestic banks) and a time-varying countercyclical leverage buffer of up to 0.9 per cent (currently set at zero per cent). At least 75 per cent of the minimum 3 per cent requirement and the entirety of any buffers that may apply must be met by CET1 capital.

The regulatory capital framework continued



The proposed leverage ratio framework does not currently give rise to higher capital requirements for the Group than the risk-based capital framework.

The PRA is expected to implement the FPC's proposals during 2015, with the FPC due to review progress in 2017. In addition both the Basel Committee and the European Commission will separately review and consider leverage ratio calibration over the next two years with final recommendations expected by 2017. The Basel Committee intends for the leverage ratio to become a Pillar 1 requirement from 1 January 2018.

FUTURE REGULATORY DEVELOPMENTS

Introduction

The Group's 2014 year end disclosures comply with the CRD IV requirements and associated guidelines and EBA technical standards in force at 31 December 2014. It is important to note that specific aspects of the CRD IV text remain dependent upon the issuance of final technical standards, guidelines, final Q&As and local regulator (PRA) decisions where applicable.

In addition to the finalisation of the details of CRD IV there are significant regulatory developments underway that may have an impact on the Group. These regulatory developments are monitored closely in order to best position the Group to adapt to any changes. Some of the key areas of development are:

Disclosure requirements

- **Basel review of the Pillar 3 disclosure requirements** – In January 2015 the Basel Committee released its 'Revised Pillar 3 disclosure requirements standards' document. The key goal of the revised Pillar 3 disclosure requirements is to improve the comparability and consistency between banks and within the various disclosures made by individual banks. Implementation of this revised framework will result in considerable change in the presentation of the Group's Pillar 3 disclosures in future periods.
- **EBA guidelines on frequency of disclosures** – In December 2014, the EBA released its final guidelines on Pillar 3 disclosure frequency that are expected to apply to the Group from the end of 2015.

Changes to capital requirements

- **Standardised review** – The Basel Committee are conducting a number of reviews into the standardised approach frameworks for credit risk, counterparty credit risk and operational risk. These reviews are expected to lead to revised standardised rules. The reviews are expected to be finalised by December 2015 with implementation by 1 January 2017.
- **Model review** – The Basel Committee are also considering various aspects of banks' internal models, for example, whether to constrain certain modelling choices or potential alternative approaches. This is to be combined with a potential new framework for capital floors which would replace the existing Basel I floor. A consultation was issued in December 2014 on methodology and the Basel Committee intends to finalise standards including calibration and implementation arrangements by end 2015.
- **Trading book review** – The Basel Committee are undertaking a fundamental review of the capital treatment of banks' trading books, with a further (third) consultation published in December 2014. The implications of the review may have a substantial impact on the way that banks define future trading and risk management strategies.
- **Counterparty credit risk (CCR)** – The Basel Committee issued its final document on methodology changes for CCR requirements in March 2014, which will impact the calculation of CCR exposures affecting capital and leverage. This regulation is to be implemented by 2017.
- **Securitisation** – The Basel Committee issued final rules in December 2014 on revisions to the securitisation framework with implications for the Group's minimum risk weights for securitisation positions going forward.

Other

- **Interest rate risk in the banking book (IRRBB)** – The Basel Committee is expected to issue a consultation paper in 2015 on the capital treatment of IRRBB. This could include proposals for a standard approach and a potential move to Pillar 1.
- **Pillar 2** – In January 2015 the PRA issued a consultation on proposals to reform the Pillar 2 framework, including new approaches for determining Pillar 2A capital requirements and the setting of Pillar 2B capital requirements (the PRA buffer).
- **Systemic risk buffer** – The FPC intends to set out a framework in 2015 for setting systemic risk buffers for UK ring-fenced banks and large building societies to take effect from 2019.
- **Liquidity coverage ratio** (LCR) – The PRA has published its consultation on transition from Individual Liquidity Adequacy Standards to the LCR becoming the Pillar 1 Regulatory Liquidity Requirement from 1 October 2015. The consultation paper proposes changes to the PRA rules and guidance and covers the transition to the new liquidity regime, interim Pillar 2 approach, regulatory reporting, requirements on firms beyond meeting the LCR and disclosure requirements.
- **Net stable funding ratio** (NSFR) – The Basel Committee published its finalised NSFR on 31 October 2014 which requires a NSFR of 100 per cent from 2018. A Basel Committee consultation on disclosure standards for the NSFR was issued in December 2014. The EBA will finalise its version by the end of 2015, with the CRD IV legislative proposal following by the end of 2016.

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 2014 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's 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 provide proactive support and constructive challenge to 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 and ensures that the 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 the Group 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 2014. 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 management continued

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 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 BRC. 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 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 111 to 113.

Further details on the Group's risk governance are presented in the Risk Management section of the 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 114 to 115.

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 2014 Lloyds Banking Group plc Annual Report and Accounts, as follows:

Conduct risk, pages 136 to 137;

Funding and liquidity risk, pages 146 to 152;

Capital risk (life insurance businesses), pages 153 to 165;

Regulatory risk, page 166;

Insurance risk, page 167;

People risk, page 168;

Financial reporting risk, page 169;

Governance risk, page 170.

THE GROUP'S APPROACH TO 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 Group Board, reflecting the Group's strategic plans, regulatory capital constraints and market expectations. It is defined by a number of minimum capital ratios in normal and stressed conditions, a minimum leverage ratio and a minimum buffer over regulatory solvency requirements for the insurance business set by the Insurance Board. The Group monitors its actual and forecast capital positions aiming to remain within its appetite at all times.

Exposures

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. This could arise due to a depletion of the Group's capital resources as a result of the crystallisation of any of the risks to which it is exposed. Alternatively a shortage of capital could arise from an increase in the amount of capital that is needed to be held. 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 defined by the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulation Authority (PRA) policy statement PS7/13. Details of the Group's regulatory capital framework are on pages 13-16.

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 the accumulation of profits over time, by raising new equity via, for example, a rights issue or debt exchange and by raising additional tier 1 and tier 2 capital by issuing subordinated securities. 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.

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 developed at a global level through the Financial Stability Board (FSB) and Basel Committee, at a European level mainly through the issuance of CRD IV technical standards and guidelines and within the UK by the PRA and through directions from the FPC. Some of the key future developments that will impact the Group are described in the 'Future regulatory developments' section on page 16.

The Group continues to monitor these developments very closely, analysing the potential financial impacts to ensure that the Group continues to maintain a strong capital position that exceeds the minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Capital management in 2014

The Group continued to strengthen its capital position during 2014 through capital-efficient profit generation, further dividends from the Insurance business, changes to and improved valuations of the Group's defined benefit pension arrangements and a reduction in risk-weighted assets. The positive impact of these items was partly offset by the recommended dividend, charges relating to legacy issues and the Enhanced Capital Notes (ECNs) exchange and tender offers where the Group repurchased the equivalent of £5bn nominal (£4bn regulatory value) of ECNs and issued £5.3bn of new CRD IV compliant AT1 securities.

– The CET1 ratio increased 2.5 percentage points from 10.3 per cent (pro forma) to 12.8 per cent.

– The leverage ratio increased 1.1 percentage points from 3.8 per cent (pro forma) to 4.9 per cent.

– The transitional total capital ratio increased 3.2 percentage points, from 18.8 per cent (pro forma) to 22.0 per cent.

– The Group is now assuming a steady state CET1 ratio requirement of around 12 per cent.

The directors have recommended a dividend of 0.75 pence per share. The dividend, amounting to approximately £535m, will be recognised in the Group's 2015 financial statements.

The Group intends to have a progressive dividend policy with dividends starting at a modest level and increasing over the medium term to a dividend payout ratio of at least 50 per cent of sustainable earnings. The ability of the Group to pay a dividend is subject to a number of constraints. Under the Companies Act 2006, dividends may only be paid out of "profits available for distribution", which are determined by reference to a company's separate financial statements. Lloyds Banking Group plc acts a holding company which also raises debt to fund the activities of the Group. The profitability of the Company is therefore dependent upon the receipt of dividends from its subsidiaries and consequently its ability to sustain dividend payments is in turn largely dependent on the ability of its subsidiaries to continue making dividend payments.

At 31 December 2014 the Company had accumulated distributable reserves of approximately £8,500m. Substantially all of the Company's merger reserve is available for distribution under UK company law as a result of transactions undertaken to recapitalise the Company in 2009.

As the parent company of a banking group payment of a dividend is also dependent upon the maintenance of an adequate level of regulatory capital. The Group remains strongly capitalised, increasing its CET1 capital ratio from 10.3 per cent at 31 December 2013 to 13.0 per cent (pre dividend) at 31 December 2014. The payment of a dividend reduces an entity's CET1 capital and, as a result, reduces its CET1 capital ratio. The current recommended dividend reduces the Group's CET1 ratio to 12.8 per cent.

Capital management

LLOYDS BANKING GROUP CAPITAL RESOURCES

The capital resources of the Group as at 31 December 2014 are presented in the table below.

Table 4:
Capital resources

	Transitional		Fully loaded	
	2014 £m	2013[2] £m	**2014 £m**	2013[2] £m
Common equity tier 1				
Shareholders' equity per balance sheet	**43,335**	39,191	**43,335**	39,191
Adjustment to retained earnings for foreseeable dividends	**(535)**	–	**(535)**	–
Deconsolidation of insurance entities[1]	**(824)**	(1,367)	**(824)**	(1,367)
Adjustment for own credit	**158**	185	**158**	185
Cash flow hedging reserve	**(1,139)**	1,055	**(1,139)**	1,055
Other adjustments	**333**	133	**333**	133
	41,328	39,197	**41,328**	39,197
Less: deductions from common equity tier 1				
Goodwill and other intangible assets	**(1,875)**	(1,979)	**(1,875)**	(1,979)
Excess of expected losses over impairment provisions and value adjustments	**(565)**	(866)	**(565)**	(866)
Removal of defined benefit pension surplus	**(909)**	(78)	**(909)**	(78)
Securitisation deductions	**(211)**	(141)	**(211)**	(141)
Significant investments[1]	**(2,546)**	(2,890)	**(2,546)**	(3,090)
Deferred tax assets	**(4,533)**	(5,025)	**(4,533)**	(5,118)
Common equity tier 1 capital	**30,689**	28,218	**30,689**	27,925
Additional tier 1				
Additional tier 1 instruments	**9,728**	4,486	**5,355**	–
Less: deductions from tier 1				
Significant investments	**(859)**	(677)	**–**	–
Total tier 1 capital	**39,558**	32,027	**36,044**	27,925
Tier 2				
Tier 2 instruments	**14,197**	19,870	**10,836**	15,636
Eligible provisions	**333**	349	**333**	349
Less: deductions from tier 2				
Significant investments	**(1,288)**	(1,015)	**(2,146)**	(1,692)
Total capital resources	**52,800**	51,231	**45,067**	42,218
Risk-weighted assets	**239,734**	272,641	**239,734**	271,908
Common equity tier 1 capital ratio (%)	**12.8%**	10.3%	**12.8%**	10.3%
Tier 1 capital ratio (%)	**16.5%**	11.7%	**15.0%**	10.3%
Total capital ratio (%)	**22.0%**	18.8%	**18.8%**	15.5%

[1] The amount of post-acquisition reserves for the Group's Insurance business are excluded from shareholders' equity. The remaining cost of the Group's investment in the equity of the Insurance business is risk-weighted as part of threshold risk-weighted assets up to a limit based on the size of the Group's common equity tier 1 capital position, with the residual amount deducted from common equity tier 1 capital.

[2] 31 December 2013 comparatives reflect CRD IV rules as implemented by the PRA as at 1 January 2014, and are reported on a pro forma basis that includes the benefit of the sales of Heidelberger Leben, Scottish Widows Investment Partnership and the Group's 50 per cent stake in Sainsbury's Bank. 31 December 2013 common equity tier 1 ratios, excluding the benefit of these sales, were 10.0 per cent fully loaded and 10.1 per cent on transitional rules, while risk-weighted assets under fully loaded rules were £271.1bn and under transitional rules were £272.1bn.

The key differences between the transitional capital calculation as at 31 December 2014 and the fully loaded equivalent are as follows:

- Capital securities that previously qualified as tier 1 or tier 2 capital, but do not qualify under CRD IV, can be included in tier 1 or tier 2 capital (as applicable) up to a specified limit which reduces by 10 per cent per annum until 2022.
- The significant investment deduction from AT1 in 2014 will transition to T2 by 2018.

MOVEMENTS IN CAPITAL

The movements in the transitional CET1, AT1, tier 2 and total capital positions in the period are provided below.

Table 5:
Movements in capital

	Common equity tier 1 £m	Additional tier 1 £m	Tier 2 £m	Total capital £m
At 31 December 2013[1]	28,218	3,809	19,204	51,231
Profit attributable to ordinary shareholders[2]	1,235	–	–	1,235
Adjustment to above re December 2013 pro forma	(202)	–	–	(202)
Adjustment to retained earnings for foreseeable dividends	(535)	–	–	(535)
Pension movements:				
Deduction of pension asset	(831)	–	–	(831)
Movement through other comprehensive income	739	–	–	739
Available-for-sale reserve	548	–	–	548
Deferred tax asset	492	–	–	492
Goodwill and intangible assets deductions	104	–	–	104
Excess of expected losses over impairment provisions and value adjustments	301	–	–	301
Significant investment deduction	344	(182)	(273)	(111)
Eligible provisions	–	–	(16)	(16)
Subordinated debt movements:				
Restructuring to ensure CRD IV compliance	–	5,355	(4,006)	1,349
Subordinated debt issuance	–	–	645	645
Repurchases, redemptions and other	–	(113)	(2,312)	(2,425)
Other movements	276	–	–	276
At 31 December 2014	30,689	8,869	13,242	52,800

[1] 31 December 2013 comparatives reflect CRD IV transitional rules implemented by the PRA as at 1 January 2014, and are reported on a pro forma basis that includes the benefit of the sales of Heidelberger Leben, Scottish Widows Investment Partnership and the Group's 50 per cent stake in Sainsbury's Bank.

[2] As the Insurance business is excluded from the scope of the Group's regulatory capital consolidation, profits made by Insurance are removed from CET1 capital. Dividends paid to the Group by Insurance, however, are recognised through CET1 capital and for the period include £400m paid in March 2014 and £300m paid in December 2014. In addition, the sale of Heidelberger Leben resulted in the payment of an additional dividend by Insurance to the Group of £295m.

CET1 capital resources have increased by £2,471m in the period, mainly due to profit attributable to ordinary shareholders, reflecting underlying profit, dividends from the Insurance business and a pensions credit resulting from changes to the Group's defined benefit pension arrangements, partly offset by changes relating to legacy issues and the ECN exchange and tender offers. Additional favourable pension valuations through other comprehensive income, favourable movements in Available-for-sale (AFS) reserves, a reduction in the excess of expected losses over impairment provisions and value adjustments and a reduction in deferred tax and significant investment deductions, further increased CET1 capital resources partially offset by an increase in the pensions asset deducted from capital and foreseeable dividends.

AT1 capital resources have increased by £5,060m in the period, mainly due to the ECN exchange and tender offers which resulted in the issuance of £5.3bn of CRD IV compliant AT1 instruments.

As a result of the offers launched in the first half of the year, the Group has met its AT1 requirement under the CRD IV capital framework. Through the exchange and tender offers, the Group repurchased the equivalent of £5bn nominal (£4bn regulatory value) of ECNs and issued £5.3bn of new AT1 securities. In addition to delivering the Group's AT1 requirement, the exchange and tender offers also increased the Group's leverage ratio by approximately 50 basis points, improved the Group's rating agency metrics, and has benefited the Group's net interest margin in 2014 by approximately 7 basis points. Coupon payments on the new AT1 securities are accounted for as distributions from reserves. The exchanges resulted in a net accounting charge of approximately £1.1bn, which has reduced the Group's fully loaded CET1 capital ratio by approximately 50 basis points.

Tier 2 capital resources have reduced by £5,962m in the period. This primarily reflects the ECN exchange and tender offers, which resulted in £4.0bn of existing tier 2 ECN instruments being redeemed in exchange for the issuance of AT1 instruments as outlined above. It also reflects a reduction of £0.5bn arising as a result of the Group's stated intention to approach the PRA to seek the appropriate permission to redeem a number of remaining ECN instruments following the Capital Disqualification Event that occurred upon the release of the PRA stress test results. Additional factors contributing to the reduction in tier 2 capital resources included a reduction in eligible provisions and other movements in tier 2 subordinated debt, including foreign exchange, fair value unwind, amortisation of dated instruments and other calls and redemptions. The reduction in tier 2 capital resources was partially offset by the issuance of a £0.6bn CRD IV compliant tier 2 dated subordinated debt instrument in November 2014.

Capital management continued

CAPITAL SECURITIES

A description of the main features of CET1, AT1 and Tier 2 instruments issued by the Group and its significant subsidiaries are included in a separate document on the Group's website located at www.lloydsbankinggroup.com/investors/financial-performance/lloyds-banking-group/

Summary information on the terms and conditions of 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 41 (Subordinated liabilities), 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 252 to 256

Note 42 (Share capital), 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 257 to 258

The full terms and conditions attached to capital securities are also available on the Group's website at http://www.lloydsbankinggroup.com/investors/debt-investors

As at 31 December 2014, the recognition, classification and valuation of these securities within the Group's regulatory capital resources were subject to the requirements of the CRD IV 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. Not all subordinated liabilities qualify as regulatory capital, and for those that do, differences between the accounting and the regulatory value can arise in relation to fair value hedge accounting adjustment, accrued interest, the regulatory amortisation of dated securities, and the deduction of the ECN embedded derivative asset. 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.

OWN FUNDS DISCLOSURES

Additional disclosures on own funds, in accordance with the requirements of the EBA technical standard on Own Funds Disclosure, are provided in Appendix 1. These consist of a detailed analysis of the components of the Group's transitional own funds and a reconciliation of own funds items to the statutory balance sheet. Separate own funds disclosures are provided from the Group's significant subsidiaries and are located in Appendices 2 and 3.

LEVERAGE RATIO

The leverage ratio is calculated by dividing tier 1 capital (excluding grandfathered tier 1 securities) by a defined measure of on-balance sheet assets and off-balance sheet items.

On 12 January 2014 the Basel Committee issued a revised Basel III leverage ratio framework that included a number of amendments to the original calculation of the exposure measure, in particular the methodologies applied in determining the exposure measures for derivatives, securities financing transactions (SFTs) and off-balance sheet items. In addition the scope of consolidation has been fully aligned to that applied to the risk-based capital framework, thereby requiring all on-balance sheet assets and off-balance sheet items of Insurance division to be excluded from the Group's total exposure measure and replaced by a measure of the banking group's investment in Insurance.

In January 2015 the existing CRD IV rules on the calculation of the leverage ratio were amended to align with the European Commission's interpretation of the revised Basel III leverage ratio framework. Although there remain some minor differences between the framework and the amended CRD IV rules, the Group does not consider these to be material and has therefore elected, in accordance with PRA guidance, to disclose on the basis of the revised Basel III leverage ratio framework, in keeping with the interim 2014 disclosures.

Table 6:
Leverage ratio

31 December 2014	Fully loaded 2014 £m	Fully loaded 2013[3] £m
Total tier 1 capital for leverage ratio[1]		
Common equity tier 1 capital	**30,689**	27,041
Additional tier 1 capital	**5,355**	–
Total tier 1 capital	**36,044**	27,041
Exposure measure[2]		
Statutory balance sheet assets		
Derivative financial instruments	**36,128**	30,804
Securities financing transactions (SFTs)	**43,772**	29,592
Loans and advances and other assets	**774,996**	781,984
Total assets	**854,896**	842,380
Deconsolidation of insurance entities		
Derivatives financial instruments	**(1,686)**	(1,030)
Loans and advances and other assets	**(143,459)**	(150,174)
Total deconsolidation adjustments	**(145,145)**	(151,204)
Derivatives adjustments		
Adjustment for regulatory netting	**(24,187)**	(20,926)
Adjustment to cash collateral	**(1,024)**	(70)
Net written credit protection	**425**	280
Regulatory potential future exposure	**12,722**	13,368
Total derivatives adjustments	**(12,064)**	(7,348)
Counterparty credit risk add-on for SFTs	**1,364**	1,921
Off-balance sheet items	**50,980**	55,987
Regulatory deductions and other adjustments	**(10,362)**	(9,382)
Total exposure	**739,669**	732,354
Leverage ratio (%)	**4.9%**	3.7%
Pro forma leverage ratio at 31 December 2013[4]		3.8%

[1] Calculated in accordance with CRD IV rules.

[2] Calculated in accordance with the revised Basel III leverage ratio framework issued in January 2014, as interpreted through the July 2014 Basel III Quantitative Impact Study instructions and related guidance.

[3] 31 December 2013 comparatives are reported on the same basis of calculation as the current year.

[4] Includes the pro forma benefit of the sales of Heidelberger Leben, Scottish Widows Investment Partnership and the Group's 50 per cent stake in Sainsbury's Bank.

Assets related to Group subsidiaries that fall outside the scope of the Group's regulatory capital consolidation are deconsolidated. These are replaced with a proportion of the Group's investment in the subsidiaries, reflecting amounts not already deducted from tier 1 capital as part of significant investment deductions. This primarily applies to the Group's insurance subsidiaries resulting in the removal of assets related to Insurance division.

Adjustments are applied to the balance sheet asset value of derivative financial instruments to reflect the application of regulatory netting rules, adjustments for the recognition of cash variation margin (subject to certain restrictions), the addition of notional amounts of written credit derivatives and the requirement to reflect potential future exposure amounts in accordance with regulatory rules.

Securities financing transactions (SFTs), predominantly comprising repurchase transactions, are subject to the netting rules imposed by the framework. These are considered to be similar to current IFRS accounting rules on netting. In addition a counterparty credit risk amount is calculated and added to the SFT measure, representing the extent to which an SFT is under-collateralised.

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. In accordance with the requirements of the 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 rules to be deducted from tier 1 capital such as deferred tax asset amounts, pension assets and goodwill and intangibles. The removal of these assets from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

Key movements

– The 1.1 per cent increase in the Group's fully loaded leverage ratio from 3.8 per cent (pro forma) to 4.9 per cent predominantly reflects the increase in the Group's tier 1 capital position over the period, including the issuance of £5.3bn of CRD IV compliant AT1 instruments and the growth in CET1 capital.

Pillar 1 Capital requirements: Overview

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 2014 are presented in the table below together with key drivers behind risk-weighted asset movements.

Table 7:
Capital requirements

	2014 Risk-weighted assets £m	2014 Pillar 1 capital requirements £m	2013 Risk-weighted assets £m	2013 Pillar 1 capital requirements £m
CREDIT RISK				
Exposures subject to the IRB approach				
Foundation IRB approach				
Corporate – main	43,735	3,499	48,771	3,902
Corporate – SME	9,637	771	10,570	846
Corporate – specialised lending	5	–	100	8
Central governments and central banks	1,618	129	1,579	126
Institutions	1,577	126	1,339	107
Retail IRB approach				
Retail mortgages	43,123	3,450	52,513	4,201
of which: residential mortgages (SME)	3,174	254	4,493	359
of which: residential mortgages (non-SME)	39,949	3,196	48,020	3,842
Qualifying revolving retail exposures	14,061	1,125	16,355	1,308
Other SME	1,982	159	2,600	208
Other non-SME	13,720	1,098	13,671	1,094
Other IRB approaches[1]				
Corporate – specialised lending	15,821	1,266	20,511	1,641
Equities – exchange traded	1,976	158	307	24
Equities – private equity	5,727	458	5,140	411
Equities – other	201	16	455	36
Securitisation positions[2]	2,373	190	3,319	266
Non-credit obligation assets[3]	5,047	404	–	–
Total – IRB approach	160,603	12,849	177,230	14,178
Exposures subject to the standardised approach				
Central governments and central banks	11	1	49	4
Regional governments or local authorities	–	–	–	–
Public sector entities	9	1	9	1
Multilateral development banks	–	–	–	–
International organisations	–	–	–	–
Institutions	53	4	295	24
Corporates	13,646	1,092	16,974	1,358
Retail	2,946	236	4,023	322
Secured by mortgages on immovable property	3,408	273	2,741	219
of which: residential property	3,396	272	2,535	203
of which: commercial property	12	1	206	16
Exposures in default	1,573	126	2,742	219
Exposures associated with particularly high risk	1	–	1	–
Covered bonds	–	–	–	–
Securitisation positions	–	–	–	–
Short-term claims on institutions and corporates	–	–	830	66
Collective investment undertakings (CIUs)	–	–	49	4
Equity exposures	–	–	–	–
Other items[3]	3,797	304	13,437	1,075
Total – standardised approach	25,444	2,037	41,150	3,292

	2014 Risk-weighted assets £m	2014 Pillar 1 capital requirements £m	2013 Risk-weighted assets £m	2013 Pillar 1 capital requirements £m
Contributions to the default fund of a central counterparty[4]	515	41	–	–
Total credit risk	186,562	14,927	218,380	17,470
Threshold – significant investments	8,309	665	–	–
Threshold – deferred tax	2,515	201	–	–
Total credit risk (transitional)	197,386	15,793	218,380	17,470
COUNTERPARTY CREDIT RISK				
IRB approach	8,638	691	7,082	566
Standardised approach	314	25	712	57
Central counterparties[5]	145	12	–	–
Settlement risk	11	1	–	–
Total counterparty credit risk	9,108	729	7,794	623
Credit valuation adjustment				
Standardised method	2,215	177	–	–
Total credit valuation adjustment	2,215	177	–	–
MARKET RISK				
Internal models approach	3,108	249	9,031	723
Standardised approach				
Interest rate position risk requirement	1,566	125	1,699	136
of which: specific interest rate risk of securitisation positions	285	23	142	11
Equity position risk requirement	–	–	11	1
Foreign exchange position risk requirement	72	6	341	27
Commodity position risk requirement	–	–	–	–
Total market risk	4,746	380	11,082	887
OPERATIONAL RISK				
Standardised approach	26,279	2,102	26,594	2,128
Total operational risk	26,279	2,102	26,594	2,128
Total	239,734	19,181	263,850	21,108

[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 per cent risk weight category. These amounts are deducted from capital after the application of SCRAs, rather than being risk-weighted assets at 1,250 per cent.

[3] Other items (Standardised Approach) and non-credit obligation assets (IRB 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 and sundry debtors.

[4] Previously reported in Institutions under the Standardised Approach following rules applicable at that time (2013: £24m risk-weighted asset).

[5] Exposures to central counterparties at 31 December 2013 carried a nil value in accordance with the rules prevailing at that time.

Pillar 1 Capital requirements: Overview continued

RISK-WEIGHTED ASSETS MOVEMENT BY KEY DRIVER

Table 8:
Risk-weighted assets movement by key driver

	Credit risk[3] £m	Counterparty credit risk[3] £m	Market risk £m	Operational risk £m	Total £m
Risk-weighted assets as at 31 December 2013[1]	**212,526**	**10,736**	**11,082**	**26,594**	**260,938**
Management of the balance sheet	(4,694)	(366)	(1,850)	–	(6,910)
Disposals	(9,781)	(170)	–	–	(9,951)
External economic factors	(10,459)	1,187	26	–	(9,246)
Model and methodology changes	(995)	(64)	(4,512)	–	(5,571)
Other	(35)	–	–	(315)	(350)
Risk-weighted assets	**186,562**	**11,323**	**4,746**	**26,279**	**228,910**
Threshold risk-weighted assets[2]					10,824
Total risk-weighted assets at 31 December 2014					**239,734**

[1] 31 December 2013 comparatives reflect CRD IV rules as at 1 January 2014, as implemented by the PRA.

[2] Threshold risk-weighted assets reflect the element of significant investment and deferred tax assets that are permitted to be risk-weighted instead of deducted from common equity tier 1 capital under threshold rules. The significant investment primarily arises from the investment in the Group's Insurance business.

[3] Credit risk includes movements in contributions to the default fund of central counterparties and counterparty credit risk includes the movements in credit valuation adjustments.

The risk-weighted asset movements table provides an analysis of the movement in risk-weighted assets in the year and an insight into the key drivers of the movements. The analysis is compiled on a monthly basis through the identification and categorisation of risk-weighted asset movements and is subject to management judgement.

Management of the balance sheet includes risk-weighted asset movements arising from new lending and asset run-off and management of market risk positions. During the year risk-weighted assets decreased £6.9bn primarily in Commercial Banking, partially offset by business growth in Consumer Finance and equities received in consideration for the disposal of Scottish Widows Investment Partnership within Central Items.

Disposals include risk-weighted asset reductions arising from the sale of assets, portfolios and businesses. Disposals reduced risk-weighted assets by £10.0bn, primarily in the Run-off portfolio, including the sale of loans in the Irish retail mortgage portfolio as well as exiting the joint venture banking operation with Sainsbury's, in Retail.

External economic factors captures movements driven by changes in the economic environment. The reduction in risk-weighted assets of £9.2bn is mainly due to positive macroeconomic factors including favourable movements in UK house prices and reduced unemployment which have led to improvements in the credit risk profile of customers.

Model and methodology changes include the movement in risk-weighted assets arising from new model implementation, model enhancement and changes in credit risk approach applied to certain portfolios. Model and methodology changes reduced risk-weighted assets by £5.6bn, primarily due to the removal of a temporary capital buffer applied to the Group's internal market risk models on completion of specific market risk infrastructure projects. Reductions in credit risk arise from a number of small methodology refinements in Commercial Banking, partially offset by risk-weighted asset increases arising from updates to mortgage models and refinement of risk models for unsecured products in Retail and Consumer Finance.

DIVISIONAL RISK-WEIGHTED ASSETS

The risk-weighted assets of the divisions as at 31 December 2014 are presented in the table below.

Table 9:
Divisional risk-weighted assets

	2014 Retail £m	2014 Commercial Banking £m	2014 Consumer Finance £m	2014 Run-off £m	2014 TSB £m	2014 Central Items £m	2014 Total £m
CREDIT RISK							
Exposures subject to the IRB approach							
Foundation IRB approach							
Corporate – main	3	39,134	2,678	1,847	–	73	43,735
Corporate – SME	2	9,188	17	430	–	–	9,637
Corporate – specialised lending	–	5	–	–	–	–	5
Central governments and central banks	–	388	–	–	–	1,230	1,618
Institutions	–	1,147	47	63	–	320	1,577
Retail IRB approach							
Retail mortgages	32,438	3,076	1,384	4,553	1,672	–	43,123
of which: residential mortgages (SME)	98	3,076	–	–	–	–	3,174
of which: residential mortgages (non-SME)	32,340	–	1,384	4,553	1,672	–	39,949
Qualifying revolving retail exposures	5,371	–	8,690	–	–	–	14,061
Other SME	713	1,269	–	–	–	–	1,982
Other non-SME	10,248	–	1,923	34	1,515	–	13,720
Other IRB approaches[1]							
Corporate – specialised lending	–	12,870	–	2,951	–	–	15,821
Equities – exchange traded	–	–	–	–	–	1,976	1,976
Equities – private equity	–	4,349	–	738	–	640	5,727
Equities – other	–	–	–	59	–	142	201
Securitisation positions[2]	–	1,052	–	1,257	–	64	2,373
Non-credit obligation assets[3]	78	130	1,229	5	–	3,605	5,047
Total – IRB approach	48,853	72,608	15,968	11,937	3,187	8,050	160,603
Exposures subject to the Standardised Approach							
Central governments and central banks	–	–	–	11	–	–	11
Public sector entities	–	1	–	8	–	–	9
Institutions	1	12	15	6	–	19	53
Corporates	1,221	8,695	641	1,562	2	1,525	13,646
Retail	535	862	254	608	687	–	2,946
Secured by mortgages on immovable property	1,780	87	61	493	987	–	3,408
of which: residential property	1,780	75	61	493	987	–	3,396
of which: commercial property	–	12	–	–	–	–	12
Exposures in default	807	184	11	538	33	–	1,573
Exposures associated with particularly high risk	–	1	–	–	–	–	1
Short-term claims on institutions and corporates	–	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–	–
Other items[3]	199	401	383	277	271	2,266	3,797
Total – standardised approach	4,543	10,243	1,365	3,503	1,980	3,810	25,444

Pillar 1 Capital requirements: Overview continued

	2014 Retail £m	2014 Commercial Banking £m	2014 Consumer Finance £m	2014 Run-off £m	2014 TSB £m	2014 Central Items £m	2014 Total £m
Contributions to the default fund of a central counterparty[4]	–	515	–	–	–	–	515
Total credit risk	53,396	83,366	17,333	15,440	5,167	11,860	186,562
Threshold – significant investments	–	–	–	–	–	8,309	8,309
Threshold – deferred tax	–	–	–	–	–	2,515	2,515
Total credit risk (transitional)	53,396	83,366	17,333	15,440	5,167	22,684	197,386
COUNTERPARTY CREDIT RISK							
IRB approach	–	8,363	–	–	–	275	8,638
Standardised approach	–	298	–	–	–	16	314
Central counterparties[5]	–	142	–	–	3	–	145
Settlement risk	–	11	–	–	–	–	11
Total counterparty credit risk	–	8,814	–	–	3	291	9,108
Credit valuation adjustment							
Standardised method	–	2,173	–	–	–	42	2,215
Total credit valuation adjustment	–	2,173	–	–	–	42	2,215
MARKET RISK							
Internal models approach	–	3,108	–	–	–	–	3,108
Standardised approach							
Interest rate position risk requirement	–	1,566	–	–	–	–	1,566
of which: specific interest rate risk of securitisation positions	–	285	–	–	–	–	285
Equity position risk requirement	–	–	–	–	–	–	–
Foreign exchange position risk requirement	–	72	–	–	–	–	72
Total market risk	–	4,746	–	–	–	–	4,746
OPERATIONAL RISK							
Standardised approach	14,270	7,086	3,549	1,374	–	–	26,279
Total operational risk	14,270	7,086	3,549	1,374	–	–	26,279
Total risk-weighted assets	67,666	106,185	20,882	16,814	5,170	23,017	239,734

	2013 Retail £m	2013 Commercial Banking £m	2013 Consumer Finance £m	2013 Run-off £m	2013 TSB £m	2013 Central Items £m	2013 Total £m
CREDIT RISK							
Exposures subject to the IRB approach							
Foundation IRB approach							
Corporate – main	7	44,971	1,756	2,037	–	–	48,771
Corporate – SME	5	10,027	17	504	17	–	10,570
Corporate – specialised lending	–	94	–	6	–	–	100
Central governments and central banks	–	426	–	2	–	1,151	1,579
Institutions	–	1,302	1	35	–	1	1,339
Retail IRB approach							
Retail mortgages	36,424	4,235	1,478	8,234	2,142	–	52,513
of which: residential mortgages (SME)	115	4,235	–	–	143	–	4,493
of which: residential mortgages (non-SME)	36,309	–	1,478	8,234	1,999	–	48,020
Qualifying revolving retail exposures	5,645	–	9,255	–	1,455	–	16,355
Other SME	647	1,801	–	–	152	–	2,600
Other non-SME	10,316	–	1,568	135	1,652	–	13,671
Other IRB approaches[1]							
Corporate – specialised lending	–	15,852	–	4,659	–	–	20,511
Equities – exchange traded	–	11	–	–	–	296	307
Equities – private equity	–	4,145	–	995	–	–	5,140
Equities – other	–	1	–	177	–	277	455
Securitisation positions[2]	–	759	–	2,553	–	7	3,319
Non-credit obligation assets[3]	–	–	–	–	–	–	–
Total – IRB approach	53,044	83,624	14,075	19,337	5,418	1,732	177,230
Exposures subject to the standardised approach							
Central governments and central banks	–	–	–	49	–	–	49
Public sector entities	–	1	–	8	–	–	9
Institutions	91	55	10	29	–	110	295
Corporates	1,249	8,105	532	5,880	–	1,208	16,974
Retail	1,703	1,143	446	729	2	–	4,023
Secured by mortgages on immovable property	1,897	136	68	640	–	–	2,741
of which: residential property	1,897	–	68	570	–	–	2,535
of which: commercial property	–	136	–	70	–	–	206
Exposures in default	841	135	46	1,720	–	–	2,742
Exposures associated with particularly high risk	–	1	–	–	–	–	1
Short-term claims on institutions and corporates	–	818	–	12	–	–	830
Collective investment undertakings (CIUs)	31	–	–	18	–	–	49
Other items[3]	475	393	1,481	587	380	10,121	13,437
Total – standardised approach	6,287	10,787	2,583	9,672	382	11,439	41,150

Pillar 1 Capital requirements: Overview continued

	2013 Retail £m	2013 Commercial Banking £m	2013 Consumer Finance £m	2013 Run-off £m	2013 TSB £m	2013 Central Items £m	2013 Total £m
Contributions to the default fund of a central counterparty[4]	–	–	–	–	–	–	–
Total credit risk	59,331	94,411	16,658	29,009	5,800	13,171	218,380
Threshold – significant investments	–	–	–	–	–	–	–
Threshold – deferred tax	–	–	–	–	–	–	–
Total credit risk	59,331	94,411	16,658	29,009	5,800	13,171	218,380
COUNTERPARTY CREDIT RISK							
IRB approach	–	6,937	–	–	–	145	7,082
Standardised approach	–	706	–	6	–	–	712
Central counterparties[5]	–	–	–	–	–	–	–
Settlement risk	–	–	–	–	–	–	–
Total counterparty credit risk	–	7,643	–	6	–	145	7,794
Credit valuation adjustment							
Standardised method	–	–	–	–	–	–	–
Total credit valuation adjustment	–	–	–	–	–	–	–
MARKET RISK							
Internal models approach	–	9,031	–	–	–	–	9,031
Standardised approach							
Interest rate position risk requirement	–	1,699	–	–	–	–	1,699
of which: specific interest rate risk of securitisation positions	–	142	–	–	–	–	142
Equity position risk requirement	–	11	–	–	–	–	11
Foreign exchange position risk requirement	–	341	–	–	–	–	341
Total market risk	–	11,082	–	–	–	–	11,082
OPERATIONAL RISK							
Standardised approach	13,732	7,707	3,478	1,677	–	–	26,594
Total operational risk	13,732	7,707	3,478	1,677	–	–	26,594
Total risk-weighted assets	73,063	120,843	20,136	30,692	5,800	13,316	263,850

[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 per cent risk weight category. These amounts are deducted from capital, after the application of SCRAs, rather than being risk-weighted at 1,250 per cent.

[3] Other items (Standardised approach) and non-credit obligation assets (IRB 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 and sundry debtors.

[4] Previously reported in Institutions under the Standardised approach following rules applicable at that time (2013: £24m risk-weighted asset).

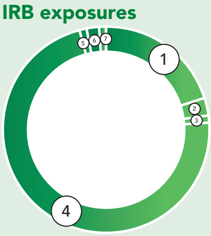
[5] Exposures to central counterparties at 31 December 2013 carried a nil value in accordance with the rules prevailing at that time.

Pillar 1 Capital requirements: Credit risk

This section details Lloyds Banking Group's credit risk profile, focusing on regulatory measures such as exposure at default and risk-weighted assets.

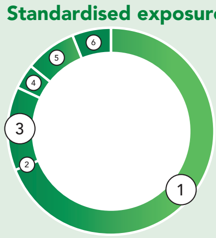
- Total credit risk risk-weighted assets decreased by 14.6% to £186.6bn, primarily due to disposals and other reductions in the Run-off portfolio and improvements in external economic factors.
- Credit risk exposures (pre-threshold) decreased by 3.4% to £700.2bn. This comprises £580.1bn of exposures risk weighted under the IRB Approach (2013: £592.5) and £120.0bn of exposures risk weighted under the Standardised Approach (2013: £132.5bn). The main drivers of the decrease were disposals and other reductions in the Run-off portfolio.
- The Group's average risk weight for credit risk exposures decreased by 2 per cent to 28 per cent overall.
- During 2014 as part of our de-risking strategy a significant reduction in expected losses and SCRAs has been achieved, £7.8bn and £7.5bn respectively.
- Given the overarching governance framework, which is applied to exposures under each asset class, the risk model management information produced, and the effective controls and processes in place, the Group is comfortable that it holds sufficient overall capital, in excess of regulatory minimum.

IRB exposures



1. Corporates 20%	(2013: 23%)
2. Central governments and central banks 3%	(2013: 3%)
3. Institutions 1%	(2013: 1%)
4. Retail 72%	(2013: 71%)
5. Equities 1%	(2013: 0%)
6. Securitisation positions 2%	(2013: 2%)
7. Non-credit obligation assets 1%	(2013: 0%)

Standardised exposures



1. Central governments and central banks 69%	(2013: 58%)
2. Institutions 0%	(2013: 1%)
3. Corporates 13%	(2013: 14%)
4. Retail 4%	(2013: 4%)
5. Secured by mortgages on immovable property 8%	(2013: 6%)
6. Other 6%	(2013: 17%)

Pillar 1 Capital requirements: Credit risk continued

OVERVIEW

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 described and reported on a monthly basis through a suite of Board metrics derived from a combination of accounting and credit portfolio performance measures, which include the use of credit risk rating systems as inputs. The Board metrics are supported by more detailed sub-Board appetite metrics at divisional and business level and by a comprehensive suite of credit risk appetite statements, credit policies, sector caps and product and country limits to manage concentration risk and exposures within the Group's approved risk appetite. The metrics cover but are not limited to geographic concentration, single name customer concentration, mortgage exposure, Loan to Value ratios (LTVs), higher risk sector concentration, limit utilisation, leveraged exposure, equity exposure, affordability and the quality of new lending.

Credit risk appetite statements and credit policies are regularly reviewed to ensure that the metrics continue to reflect the Group's risk appetite appropriately.

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 of the Group are set out on page 53. Credit risk exposures are categorised as 'retail', arising primarily in the Retail, Consumer Finance and Run-off divisions, and SMEs and corporate (including corporates, banks, financial institutions and sovereigns) arising primarily in the Commercial Banking and Run-off divisions.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer or bank 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.

Credit risk can also arise from debt securities, private equity investments and derivatives. The total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2014 is shown on page 102. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. Such amounts are reflected in note 54 on page 293 of the Annual Report and Accounts. Further information on derivatives is provided in the Counterparty Credit Risk section on page 97.

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 credit risk exposures are primarily measured using internal ratings based systems approach, with the remainder measured under the standardised approach. The Group's application of these approaches is explained in more detail on pages 38 to 40.

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 and monitored 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 Divisional Risk Committees, 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.

Further details are provided on page 120 of the Risk Management section of the 2014 Lloyds Banking Group Plc Annual Report and Accounts.

CREDIT RISK MITIGATION

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

Credit principles, risk policies and appetite statements: Risk Division sets out the credit principles, risk policies and risk appetite statements. Principles and policies are reviewed regularly, and any changes are subject to a review and approval process. Policies and risk appetite statements, where appropriate, are supported by lending guidelines, which provide a disciplined and focused benchmark for credit decisions. Collectively they 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 appetite tolerances. 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. The designated model owner 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 customer and bank limit guidelines. Credit policies and appetite statements are aligned to the Group's risk appetite and restricts exposure to higher risk countries and more vulnerable sectors and segments. Note 18 on page 222 of the Annual Report and Accounts, provides an analysis of loans and advances to customers by industry (for commercial customers) and product (for retail customers). 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 risk appetite 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 on page 120 of the Annual Report and Accounts); 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. Exercises focused on individual divisions and portfolios are performed in addition to the Group led and regulatory stress tests. For further information on the stress testing process, methodology and governance refer to page 111 of the Annual Report and 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 oversight within Risk Division is also undertaken by independent Credit Risk Oversight functions operating within Retail and Consumer Credit Risk and Commercial Banking Risk which are part of the Group's second line of defence. Its primary objective is to provide reasonable and independent oversight that credit risk is being managed with appropriate and effective controls. Oversight is executed through a combination of standard and non-standard reviews. Group Audit performs third line review of credit risk assurance.

For further information on approaches to mitigate credit risk see pages 118 to 119 of the Annual Report and Accounts.

Additional mitigation for Retail and Consumer Finance customers

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 a stressed interest rate scenario. 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.

In 2014 the Group updated its policy for high-value mortgage lending, to restrict UK mortgage applications for greater than £500,000 to a maximum income multiple of four. This was a targeted policy change primarily designed to address specific inflationary pressures in the London housing market.

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 the UK Government's Help to Buy scheme. For mainstream mortgages the Group has maximum per cent LTV limits which depend upon the loan size. These limits are currently:

Pillar 1 Capital requirements: Credit risk continued

Table 10:
UK mainstream 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 ensures that lending is affordable and sustainable. The Group takes reasonable steps to validate information used in the assessment of a customer's income and expenditure. 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.

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 small exposures on SME customers where relationship managers have limited delegated sanctioning authority, credit risk in commercial customer portfolios are subject to sanction by the independent Risk Division, which considers the strengths and weaknesses of individual transactions, the balance of risk and reward and how credit risk aligns to the Group's risk appetite. 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 and consumer underwriting is generally the same as that for assets intended to be held 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 against agreed confidence intervals. 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 and bank counterparties/customers are:

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

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 (ABS) 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 values are 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.

Refer to note 54 of the Annual Report and Accounts for further information on collateral.

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.

OTHER CREDIT RISK TRANSFERS

The Group also undertakes 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

Only certain types of collateral are deemed eligible for regulatory capital purposes. 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.

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

Eligible financial collateral

- Eligible financial collateral includes cash on deposit with 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.
- The Group predominantly applies cash collateral to the IRB corporate main,corporate SME and institutions asset classes.
- For standardised counterparty credit risk exposures, the Group largely applies cash collateral to its central government and central banks and institution exposures.

Other eligible collateral

- Other eligible collateral includes real estate, short term financial receivables, credit insurance, life policies and other physical collateral for example, cars and motorcycles in Consumer Finance (as specified through the Group's FIRB waiver permission) providing the criteria for recognition is met.
- Real estate collateral includes mortgages or charges over residential and commercial properties.
- The Group largely applies other eligible collateral to the IRB corporate main, corporate SME and retail asset classes.

Credit derivatives

- Credit derivatives are a method of transferring credit risk from one counterparty (the protection buyer) to another (the protection seller). Capital relief under regulatory requirements is restricted to the following types of credit derivative: Credit Default Swaps (CDS); Total Return Swaps; and Credit Linked Notes (to the extent of their cash funding).
- Further details on the application within the Group are included within the Counterparty Credit Risk section of the document on page 102.

Guarantees

- Guarantees from eligible protection providers, including governments, institutions and corporates, can provide regulatory capital relief, although there are minimum operational and legal requirements to reflect the risk mitigating effect. 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 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.
- Regulatory capital relief is taken through the use of PD substitution for guarantees provided by appropriate institutions or corporates. Where collateralised guarantees are available, for example in IRB corporate main, the Group adjusts the relevant LGD value.

Master netting

- Master netting agreements can reduce the credit risk for a counterparty 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 applies this predominantly to the IRB corporate main and corporate SME asset classes.

Pillar 1 Capital requirements: Credit risk continued

APPLICATION OF CREDIT RISK MITIGATION

	Standardised		IRB		
	EAD	Other	EAD	LGD	PD
Eligible financial collateral					
trading book	✓		✓		
non-trading book	✓			✓	
Other eligible collateral					
real estate collateral[1]		✓		✓	
credit insurance		✓		✓	
receivables	✓			✓	
life policies	✓			✓	
Credit derivatives[2]		✓			✓
Collateralised guarantees[2]		✓		✓	
Non collateralised guarantees[2]		✓			✓
Master netting (on and off balance sheet)	✓		✓		

[1] Real estate collateral determines the exposure class as explained below.

[2] As per application under the Substitution Approach, as explained below.

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 (FCCM) applying adjustments for volatility and currency mismatch, in addition to maturity mismatches for all collateral types.

For unfunded credit protection, for example where guarantees or credit derivatives apply, the exposure class and therefore risk weight applied to the portion of the exposure covered by the protection provider is based on the exposure class of the provider, referred to as the Substitution Approach. 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.

Real estate collateral does not impact EAD directly under the Standardised Approach, however, it instead determines the exposure class and directly impacts the risk-weight applied to the exposure.

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 83 to 95 and 96 to 102 respectively.

Where a credit risk exposure is subject to a master netting agreement the EAD value is adjusted accordingly.

Application under the IRB approach

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

Other eligible collateral, collateralised guarantees and real estate collateral applied under the Foundation IRB Approach will typically result in an adjustment to the regulatory LGD value, subject to floors as prescribed in the CRR. The adjustment applied is dependent on the value and type of collateral used. Under the AIRB approach, own estimates of LGD are used, taking into account eligible collateral among other factors.

Where appropriate guarantees or credit derivatives apply, the PD applied to the portion of the exposure covered by the protection provider is based on the PD of the provider, referred to as the PD substitution approach. The covered portion is determined after the application of 'haircuts' for currency and maturity mismatch applied to the protection provided. The PD applied to the uncovered portion of the exposure is not impacted.

Where a credit risk exposure is subject to a master netting agreement the EAD value is adjusted accordingly.

ANALYSIS OF CREDIT RISK MITIGATION

The following tables provide an analysis of FIRB 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.

Table 11:
Eligible financial collateral and other eligible collateral

	2014 Exposures covered by eligible financial collateral £m	2014 Exposures covered by other eligible collateral £m	2014 Total £m	2013 Exposures covered by eligible financial collateral £m	2013 Exposures covered by other eligible collateral £m	2013 Total £m
Exposures subject to the IRB Approach						
Foundation IRB Approach						
Corporate – Main	955	9,138	10,093	3,663	13,207	16,870
Corporate – SME	29	7,608	7,637	197	9,256	9,453
Institutions	567	–	567	686	–	686
Other IRB Approach						
Corporate – Specialised lending	718	–	718	858	–	858
Total – IRB Approach	2,269	16,746	19,015	5,404	22,463	27,867
Exposures subject to the Standardised Approach						
Corporates	669	–	669	1,269	–	1,269
Exposures in default	2	–	2	5	–	5
Total – Standardised Approach	671	–	671	1,274	–	1,274
Total	2,940	16,746	19,686	6,678	22,463	29,141

Key movements

- Total IRB approach exposures covered by financial and other eligible collateral reduced by £3.1bn and £5.7bn respectively in the period. These primarily reflect a reduction in cash collateral and real estate largely as a result of disposals in the Run-off portfolio, including a number of hotel and property development assets, and balance sheet management in the core portfolio.
- Standardised approach exposures covered by financial and other eligible financial collateral reduced by £0.6bn in the year, in the main as a result of asset disposals and repayments.

Unfunded credit protection: Guarantees and credit derivatives

Protection Provider	2014 Credit protection provided in the form of guarantees £m	2014 Credit protection provided in the form of credit derivatives £m	2014 Total £m	2013 Credit protection provided in the form of guarantees £m	2013 Credit protection provided in the form of credit derivatives £m	2013 Total £m
Exposures subject to the IRB Approach						
Central governments and central banks	5	–	5	334	–	334
Institutions	100	48	148	99	–	99
Corporate – Main	333	–	333	87	8	95
Exposures subject to the Standardised Approach						
Central governments and central banks	188	83	271	188	83	271
Total	626	131	757	708	91	799

Key movements

- As shown in the table above, the Group recognises relatively limited amounts of unfunded credit protection in its capital numbers, with there being a consistency of value from 2013 to 2014. Examples of the protection held by the Group include Export Credit Agency guarantees which are designed to support and encourage cross border trade, parental guarantees provided by PLC's to their subsidiaries, and bank guarantees provided on behalf of Corporates.

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, 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 293 to 317

Pillar 1 Capital requirements: Credit risk continued

REGULATORY APPROACH TO CREDIT RISK

EXPOSURES SUBJECT TO THE STANDARDISED APPROACH

Under CRD IV, the Standardised Approach relies on the application of a standard set of risk weights to credit risk exposures, dependant on a number of factors including the applicable asset class and underlying credit quality.

The Standardised Approach takes account of credit risk mitigation that the Group has against an exposure, before the relevant risk weight is applied to the adjusted exposure amount. Unlike exposures modelled using the Group's internal ratings, there is no distinction made between expected and unexpected losses for exposures on the Standardised Approach. Where applicable further reductions to RWAs are made in respect of eligible SMEs.

Under this approach banks can utilise risk assessments from External Credit Assessment Institutions (ECAIs) for a number of exposure classes including corporates, central governments and central banks and institutions. 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 CRD IV, based on the PRA's mapping of credit assessments to credit quality steps as detailed under PS07/13.

The Group makes limited use of ECAIs assessments for its Standardised exposures. This typically applies in the case of certain central government and central bank and institution exposures. The Group makes use of credit assessments provided by Standard & Poor's, Moody's and Fitch. Where there are no available credit assessments to utilise, risk weights are assigned to these exposures in accordance with CRD IV requirements for unrated exposures.

Within the Group, the Standardised Approach is applied to portfolios that are either on the Group's roll-out plan or are permanently exempt from the IRB approach under the terms of the Group's IRB Waiver permission. The most significant portfolio on permanent exemption relates to sovereign exposures within the UK and EU. The Group's permanent exemption list together with the IRB roll-out plan are reviewed on a regular basis internally and by the PRA.

The tables from page 70 indicate the respective risk weights applied to credit risk exposures subject to the Standardised Approach, by asset class, together with the associated exposure and RWA.

EXPOSURES SUBJECT TO THE INTERNAL RATINGS BASED APPROACH

There are two main approaches for commercial exposures – Foundation IRB and Advanced IRB. For retail exposures, a single Retail IRB approach is available. RIRB is equivalent in complexity to AIRB.

All IRB approaches require firms to use of their own internal assessment of counterparty PDs. In addition, firms applying the AIRB and/or RIRB approaches are required to use internal assessments of EAD and LGD parameters. Firms applying the FIRB approach are required to use EAD and LGD parameters set by the regulator.

The PD, LGD and EAD of an exposure form the base inputs to the calculation used to derive the RWA of that exposure. Additionally an Expected Loss (EL) is derived by multiplying the PD, LGD and EAD risk components. Where EL exceeds SCRAs linked to the underlying credit risk exposures the resultant 'excess EL' is deducted from capital resources. Where SCRAs exceed expected losses, a 'surplus provision' may be recognised in Tier 2 capital subject to certain restrictions. Further information on the calculation of Excess EL can be found on defaulted exposures on page 50.

SCOPE OF THE IRB PERMISSION

The Group has regulatory approval, subject to annual CRR attestations, to use its internal models in the calculation of the majority of its credit risk capital requirements. The Group currently has permission to use both the FIRB Approach (for corporate exposures) and the RIRB Approach (for retail exposures).

The Group applies the Supervisory Slotting Approach to certain corporate specialised lending exposures (including the Group's commercial real estate exposures) and the Simple Risk Weight Method to equity exposures. Securitisation positions are predominantly risk-weighted under the RBA, with limited use made of the IAA.

Under the Group's IRB rating permission, the following models (excluding portfolios on Supervisory Slotting) are deemed significant having RWAs in excess of £4bn.

Approach	Basel asset class	Ratings system	Associated portfolio (RWAs)	Model type
FIRB	Corporate main	Unquoted	>£15bn	PD
FIRB	Corporate main	Publicly quoted	>£15bn	PD
RIRB	Retail mortgages	Halifax mainstream mortgages	£10bn – £15bn	PD, EAD, LGD
FIRB/RIRB	Corporate main, Corporate SME, Retail SME and Retail mortgages SME	Business Dynamic Credit Scoring (BDCS)	£4bn – £10bn	PD, EAD, LGD
RIRB	Retail mortgages	Lloyds Bank mortgages	£4bn – £10bn	PD, EAD, LGD
RIRB	Other retail	Lloyds Bank personal loans	£4bn – £10bn	PD, EAD, LGD
RIRB	Retail mortgages	BOS Ireland mortgages	£4bn – £10bn	PD, EAD, LGD
RIRB	Qualifying revolving retail exposure	HBOS credit cards	£4bn – £10bn	PD, EAD, LGD
RIRB	Qualifying revolving retail exposure	Lloyds credit cards	£4bn – £10bn	PD, EAD, LGD
RIRB	Retail mortgages	HBOS Buy-to-Let mortgages	£4bn – £10bn	PD, EAD, LGD

Further details on other areas such as the Supervisory Slotting Approach for Corporate Specialised Lending exposures, Simple Risk Weight Method for Equities and various approaches for Securitisations can be found in the relevant sections later in the document.

Main differences between models within each asset class

PD ratings can adhere to a variety of philosophies including 'Point-in-time' (PIT), 'Through-the-cycle' (TTC) and 'Hybrid'.

A very long history of default data is available within the Group, allowing the most material retail mortgage portfolios to be calibrated on a TTC basis. As is standard practice in the UK, all of the Group's unsecured product PD ratings are PIT. Corporate PD models are calibrated to a long-run of default experience, meaning the PD predictions are TTC in nature.

Key characteristics of material Group ratings systems

The Group always aims to consider the longest history of representative data available when building its capital models:

– mortgage models are built on data dating back to 1987
– credit card models are built on data dating back to 2002
– personal loans models are built on data dating back to 2005
– unquoted companies models use data back to 2002
– publicly quoted companies model uses data from 2004

In general the Group's models are built using logistic regression, but in the case of the publicly quoted model, a ratings replication approach has been taken.

– corporate lending: 90 days past due; satisfying our 'unlikeliness-to-pay' or 'distressed restructure' criteria.
– retail mortgages: six cumulative missed payments; or property in repossession or personal insolvency of the borrower.
– retail other: transferred to recoveries or ninety days in arrears or three cumulative missed payments; personal bankruptcy; entry into a repayment plan; or when the borrower is deceased.

The PD models are all 'bottom-up' style models, based on a number of counterparty-specific or account-specific factors. In retail portfolios, this includes application and behavioural scorecards; in wholesale portfolios, this includes counterparty quantitative (e.g. financial) and qualitative (e.g. assessment of management) factors.

All of the Group's LGD and EAD models are calibrated on a downturn basis. Precise details vary by portfolio, but include: mortgage models including internal data and regulatory guidance relating to the early 1990s recession; unsecured retail exposures including the lowest recovery rates observed in representative data; credit card EAD models considering observed headroom utilisation in representative data.

Pillar 1 Capital requirements: Credit risk continued

INTERNAL DEVELOPMENT AND MONITORING OF IRB MODELS

Internal model development, controls and changes

Risk models (including all IRB models) and changes to them are generally developed using internal data and standard statistical techniques by the relevant business area modelling teams (the 'first line'). The models are challenged, both technically and from a business usage perspective, by an independent 'second line' unit which reports through an independent reporting line (within the Risk Division).

The Group's most material models are approved and monitored by the Group Risk Committee (GRC). GRC is the most senior executive risk committee in the Group, and its membership includes the Group Chief Executive, the Chief Financial Officer and the Chief Risk Officer, as well as representation from each Division of the Group.

Lower materiality models are approved and monitored by the Model Governance Committee (MGC). MGC has delegated approval responsibility from GRC. MGC attendees include risk and business model owners responsible for the model under consideration.

Once a model has been approved, it is subject to ongoing monitoring and periodic validation requirements.

Where appropriate, where there is a regulatory requirement, and where model weaknesses are observed, additional conservatism is applied to ensure capital adequacy. All new IRB models and all material model changes are subject to internal governance and external 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 and immediate "post model adjustment" basis, until the model is remediated to correct for the underlying weakness. All such adjustments require senior management approval, and are subsequently monitored and reported to the PRA.

Relationships between risk management function and internal audit function

Group Audit (the 'third line' of the three lines of defence model) check that appropriate controls and processes are in place and operating effectively, across all aspects of capital models. Group Audit are independent from the first and second lines of defence, reporting through to the Group Audit Director, a Group Executive Committee attendee.

A summary of how GRC, MGC and the three lines of defence (business area modelling teams; Risk Model Approval Team; and Group Audit) fit in the overall corporate governance framework is given in the Annual Report & Accounts (page 113).

Scope and main content of risk model reporting

A hierarchy of reporting exists for all risk models – detailed regular technical risk model performance (including rank ordering and predictive accuracy), is undertaken, and is used to prioritise both model changes and corrective action for model underperformance. This is supplemented by more summarised quarterly reporting to MGC and half yearly reporting to GRC. Risk model reporting is also provided to the PRA.

Given the overarching governance framework, which is applied to exposures under each asset class, the risk model management information produced, and the effective controls and processes in place, the Group is comfortable that it holds sufficient overall capital, in excess of the regulatory minimum.

INTERNAL APPLICATION OF THE IRB APPROACH

In addition to the regulatory capital calculation process, IRB models are also used for other purposes within the Group for example:

Credit approval: IRB models are strongly linked with the credit approval process, although the precise nature differs between asset classes. For retail exposures, operational application and behavioural scorecards (primarily used to make retail credit approval decisions) are key components of the PD. For Corporate 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 portfolio reporting and risk appetite: IRB parameters are embedded into management information at both Group and Divisional levels and are used to inform the setting of risk appetite.

Pricing: IRB outputs are used within pricing tools within the business to allow for risk-adjusted pricing and strategy decisions.

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

MODEL PERFORMANCE

This section provides an analysis of the performance of IRB models over 2012-2014.

The table below outlines the predicted and actual PD, LGD, and EAD ratio (ratio of predicted to actual) by exposure class. No LGD or EAD information is provided for exposures modelled under the FIRB Approach since these are determined by regulatory values.

The calculations for PD consider the portfolio of non-defaulted accounts at the start of the period and compare the default level experienced during the year to the default level predicted by the Group's regulatory capital models at the start of the period.

The calculations for LGD consider the portfolio of defaulted accounts during the relevant period and compare the loss level experienced on these accounts with the amounts predicted by the Group's regulatory capital models at the start of the period. For those assets where losses are not yet realised the determination of actual LGD includes estimates of future recoveries.

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

The calculations for the EAD ratio consider the portfolio of defaulted accounts during the relevant period and compare the EAD for these accounts with the amounts predicted by the Group's regulatory capital models at the start of the period. Where the predicted EAD was greater than the actual exposure on the date of default, the ratio will be greater than one.

Care should be taken in interpreting the predicted to actual ratios:

– 'Actual' (i.e. observed default and loss) outcome data is by its nature 'point-in-time' and reflects 2014 experience, whereas some model 'predicted' outputs are 'through-the-cycle' or 'downturn'. The gap between 'predicted' and 'actual' outcomes will therefore narrow or widen to reflect current position in the economic cycle.
– Changes in portfolio composition can affect 'actual' observed defaults over the course of a year, but will not adjust the 'predicted' factors at the start of an outcome period.
– Other changes in economic factors, lending behaviour and operational factors may also make comparisons less meaningful.
– A number of models are built on an 'account-weighted' (rather than 'exposure-weighted' basis) meaning that comparisons can be skewed.
– Data can also be skewed by small numbers of large defaults.

MODEL PERFORMANCE DATA

Table 12:
Model performance

	Probability of default		Loss given default of defaulted assets		EAD of defaulted assets
IRB exposure class	Predicted Dec 13 %	Actual Dec 14 %	Predicted Dec 13 %	Actual Dec 14 %	Ratio of predicted to actual %
Central governments and central banks	0.02%	0.00%			
Institutions	0.21%	0.00%			
Corporate – total	0.99%	1.06%			
Retail – mortgage total	1.76%	1.04%	14.87%	7.42%	103%
Retail – SME	3.92%	2.69%	62.32%	58.35%	107%
Retail – Qualifying Revolving Retail Exposure (QRRE)	2.40%	1.85%	80.03%	65.20%	113%
Retail – other	4.26%	3.45%	78.52%	66.64%	109%

Pillar 1 Capital requirements: Credit risk continued

	Probability of default		Loss given default of defaulted assets		EAD of defaulted assets
IRB exposure class	Predicted Dec 12 %	Actual Dec 13 %	Predicted Dec 12 %	Actual Dec 13 %	Ratio of predicted to actual %
Central governments and central banks	0.02%	0.00%			
Institutions	0.20%	0.02%			
Corporate – total[1]	1.89%	1.88%			
Retail – mortgage total	2.12%	1.37%	15.85%	7.09%	103%
Retail – SME	4.17%	3.13%	63.13%	66.03%	104%
Retail – QRRE	2.84%	2.60%	78.56%	68.88%	107%
Retail – other	4.91%	4.69%	81.56%	68.91%	109%

[1] Commercial Real Estate portfolios were transferred to the IRB Supervisory Slotting Approach during 2013 and are therefore excluded from this analysis.

	Probability of default		Loss given default of defaulted assets		EAD of defaulted assets
IRB exposure class	Predicted Dec 11 %	Actual Dec 12 %	Predicted Dec 11 %	Actual Dec 12 %	Ratio of predicted to actual %
Central governments and central banks	0.03%	0.00%			
Institutions	0.08%	0.00%			
Corporate – total	2.05%	2.76%			
Retail – mortgage total	2.15%	1.50%	16.08%	8.04%	103%
Retail – SME	4.51%	3.95%	64.44%	63.17%	105%
Retail – QRRE	3.38%	2.77%	78.71%	66.54%	110%
Retail – other	5.98%	5.01%	81.74%	66.36%	109%

Model Performance Status

- The Group's models maintain a conservative approach overall with the majority of predicted PD, LGD and EAD values exceeding the actual amounts observed in 2014.
- The actual versus predicted comparison can easily be skewed by a small number of large exposure default cases. This occurred in Corporates in 2014, where one high value instance of default pushed the actual number higher than expected. Excluding this single default event from the data set, shows a conservative actual versus predicted position.

Key Movements in 2014

- For the majority of portfolios the predicted and actual default rates have fallen in the year to 2014, particularly for Corporate reflecting an improvement in credit quality within the portfolio.
- Predicted and actual LGD levels across exposure classes are broadly consistent with prior years.
- EAD ratios are also relatively consistent with 2013, although there has been a relative increase for predicted values for QRRE reflecting improved credit management and collection strategies.

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 individually or collectively assessed.

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, 2014 Lloyds Banking Group plc Annual Report and Accounts:

– (1) Assets accounted for at amortised cost, pages 193 to 194
– (2) Available-for-sale financial assets, page 194

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 Central 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, 2014 Lloyds Banking Group plc Annual Report and Accounts:

– Retail Customers, pages 120 to 121;
– Commercial Customers page 121;

Treatment of customers experiencing financial stress, Note 54 (Financial risk management), Notes to the Consolidated Financial Statements, 2014 Lloyds Banking Group plc Annual Report and Accounts:

– Retail customers, pages 305 to 307;
– Consumer Finance customers, page 308;
– Commercial customers, pages 310 to 313

Pillar 1 Capital requirements: Credit risk continued

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 2014, past due but not impaired exposures in respect of loans and advances to customers amounted to £11.5bn (2013: £13.7bn). Impaired exposures in respect of loans and advances to customers amounted to £14.3bn (2013: £32.3bn), of which £2.4bn (2013: £3.8bn) were classified as 'impaired – no provision required' and the remaining £11.9bn (2013: £28.5bn) 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 2014, by major industrial sector, is provided in the table below.

Table 13:
Past due but not impaired and impaired loans and advances analysed by major industrial sector

	Past due but not impaired		Impaired	
	2014 £m	2014 As a % of credit risk exposure	2014 £m	2014 As a % of credit risk exposure
Agriculture, forestry and fishing	123	1.74%	100	1.41%
Energy and water supply	3	0.06%	145	2.80%
Manufacturing	3	0.02%	201	1.27%
Construction	261	5.05%	840	16.24%
Transport, distribution and hotels	116	0.51%	1,681	7.34%
Postal and communications	–	–	353	10.66%
Property companies	56	0.15%	3,769	10.38%
Financial, business and other services	204	0.12%	1,381	0.80%
Personal: mortgages	10,311	2.87%	4,344	1.21%
Personal: other	312	0.65%	1,418	2.96%
Lease financing	4	0.11%	1	0.03%
Hire purchase	80	1.10%	75	1.03%
Total	**11,473**	**1.64%**	**14,308**	**2.04%**

	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%

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 2014, by geographical region, based on the country of residence of the customer, is provided in the table below.

Table 14:
Past due but not impaired and impaired loans and advances analysed by major geographical region

	Past due but not impaired		Impaired	
	2014 £m	2014 As a % of credit risk exposure	2014 £m	2014 As a % of credit risk exposure
United Kingdom	**10,891**	**1.79%**	**10,402**	**1.71%**
Rest of Europe	**540**	**1.40%**	**3,595**	**9.32%**
United States of America	**–**	**–**	**82**	**0.26%**
Asia-Pacific	**41**	**1.77%**	**137**	**5.90%**
Other	**1**	**0.02%**	**92**	**1.88%**
Total	**11,473**	**1.64%**	**14,308**	**2.04%**

	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%

ANALYSIS OF SPECIFIC CREDIT RISK ADJUSTMENTS (SCRA'S) IN RESPECT OF LOANS AND ADVANCES TO CUSTOMERS

SCRAs include accounting impairment provisions and certain acquisition related fair value adjustments. These acquisition related fair value adjustments are offset against excess expected loss, in relation to Retail IRB residential mortgages.

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 2013 to 31 December 2014, in respect of loans and advances to customers is provided below.

Table 15:
Movement in impairment provisions (loans and advances to customers)

	£m
At 31 December 2013	11,966
Exchange and other adjustments	(410)
Disposal of businesses	–
Advances written off	(6,432)
Recoveries of advances written off in previous years	681
Unwinding of discount	(126)
Charge to the income statement	735
At 31 December 2014	**6,414**
(Lloyds Banking Group plc Annual Report and Accounts 2014, page 225)	

	£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	11,966

Pillar 1 Capital requirements: Credit risk continued

The movement in acquisition related fair value adjustments, from 31 December 2013 to 31 December 2014, in respect of loans and advances to customers within portfolio's applying the internal ratings based approach is provided below[1].

Table 16:
Movement in acquisition related fair value adjustments (loans and advances to customers)

	£m
At 31 December 2013	668
Fair value unwind[1]:	
in respect of impairment losses	(245)
other, including market liquidity	(30)
At 31 December 2014	**393**

[1] The fair value adjustments relating to loans and advances were those required to reflect the HBOS assets in the Group's consolidated financial records at their fair value and took into account both the expected losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires significant management judgement to determine its timing which includes an assessment of whether the losses incurred in the current period were expected at the date of acquisition and assessing whether the remaining losses expected at the date of acquisition will still be incurred. The element related to market liquidity unwinds to the income statement over the estimated expected lives of the related assets although if an asset is written-off or suffers previously unexpected impairment then this element of the fair value will no longer be considered a timing difference (liquidity) but permanent (impairment). The fair value unwind in respect of impairment losses incurred for loans and advances to customers within portfolios applying the internal ratings based approach was £245m for the period ended 31 December 2014.

Analysis by industry

An analysis of closing impairment provisions, the net charge to the income statement and acquisition related fair value adjustments in respect of loans and advances to customers, by major industrial sector, is provided in the table below.

Table 17:

Impairment provisions, net charge and acquisition related fair value adjustments analysed by major industrial sector

	2014 Impairment provisions[1] £m	2014 Net charge[1] £m	2014 Acquisition related fair value adjustments[2] £m
Agriculture, forestry and fishing	18	2	–
Energy and water supply	61	28	–
Manufacturings	179	(4)	–
Construction	158	(81)	–
Transport, distribution and hotels	1,051	198	–
Postal and communications	17	6	–
Property companies	2,553	40	–
Financial, business and other services	1,225	179	–
Personal: mortgages	460	(138)	393
Personal: other	607	536	–
Lease financing	1	(1)	–
Hire purchase	84	(30)	–
Total	**6,414**	**735**	**393**

	2013 Impairment provisions[1] £m	2013 Net charge[1] £m	2013 Acquisition related fair value adjustments[2] £m
Agriculture, forestry and fishing	38	–	–
Energy and water supply	149	95	–
Manufacturing	296	31	–
Construction	395	66	–
Transport, distribution and hotels	1,954	421	–
Postal and communications	11	(3)	–
Property companies	5,145	457	–
Financial, business and other services	2,293	552	–
Personal: mortgages	657	224	668
Personal: other	919	920	–
Lease financing	6	(26)	–
Hire purchase	103	(12)	–
Total	11,966	2,725	668

[1] Impairment provisions and net charge information presented above extracted from the 'Summary of Loan Loss Experience' analysis presented on pages 81 to 90 of the 2014 Form 20-F.

[2] The acquisition related fair value adjustments represent SCRAs recognised in the calculation of excess expected loss amounts for exposures subject to the IRB approach (as presented on page 50).

Pillar 1 Capital requirements: Credit risk continued

Analysis by geography

An analysis of closing impairment provisions, the net charge to the income statement and acquisition related fair value adjustments 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 18:
Impairment provisions, net charges and acquisition related fair value adjustments analysed by geographical region

	2014 Impairment provisions £m	2014 Net charge £m	2014 Acquisition related fair value adjustments[2] £m
United Kingdom	**4,575**	**842**	**393**
Rest of Europe	**2,848**	**329**	**–**
United States of America	**87**	**5**	**–**
Asia-Pacific	**52**	**4**	**–**
Other	**90**	**3**	**–**
	7,652	**1,183**	**393**
Fair value and other adjustments[1]	**(1,238)**	**(448)**	
Total	**6,414**	**735**	**393**

	2013 Impairment provisions £m	2013 Net charge £m	2013 Acquisition related fair value adjustments[2] £m
United Kingdom	8,392	2,349	668
Rest of Europe	7,091	628	–
United States of America	89	2	–
Asia-Pacific	66	14	–
Other	69	(5)	–
	15,707	2,988	668
Fair value and other adjustments[1]	(3,741)	(263)	
Total	11,966	2,725	668

[1] Analysis of closing impairment provisions and the net charge to the income statement in respect of loans and advances to customers, by geographical region, has been presented prior to the application of fair value and other adjustments. Further details on the fair value and other adjustments applied in respect of impairment provisions can be found on page 296 of the 2014 Lloyds Banking Group plc Annual Report and Accounts.

[2] The acquisition related fair value adjustments represent SCRAs recognised in the calculation of excess expected loss amounts on IRB portfolios (as presented on page 50).

IMPAIRED LOANS AND ADVANCES TO BANKS

As at 31 December 2014, loans and advances to banks amounting to £nil (2013: £nil) were deemed to be impaired. Impairment provisions held in respect of these impaired balances amounted to £nil (2013: £nil). An analysis of the movement in impairment provisions, from 31 December 2013 to 31 December 2014, is provided below.

Table 19:
Movement in impairment provisions (loans and advances to banks)

	£m
At 31 December 2013	–
Advances written off	–
At 31 December 2014	**–**
(Lloyds Banking Group plc Annual Report and Accounts 2014, page 225)	

	£m
At 31 December 2012	3
Advances written off	(3)
At 31 December 2013	–

IMPAIRED DEBT SECURITIES CLASSIFIED AS LOANS AND RECEIVABLES

As at 31 December 2014, impairment provisions held in respect of debt securities classified as loans and receivables amounted to £126m (2013: £125m). An analysis of the movement in impairment provisions, from 31 December 2013 to 31 December 2014, is provided below.

Table 20:
Movement in impairment provisions (debt securities)

	£m
At 31 December 2013	125
Exchange and other adjustments	9
Advances written off	(10)
Charge to the income statement	2
At 31 December 2014	**126**
(Lloyds Banking Group plc Annual Report and Accounts 2014, page 225)	

	£m
At 31 December 2012	206
Exchange and other adjustments	–
Advances written off	(82)
Charge to the income statement	1
At 31 December 2013	125

Pillar 1 Capital requirements: Credit risk continued

FACTORS IMPACTING LOSS EXPERIENCE

The overall impairment charge reduced by 60 per cent to £1.2bn as a result of a significant reduction in run-off business and improvements in all divisions. The improvement reflects lower levels of new impairment as a result of effective risk management, improving economic conditions and the continued low interest rate environment. The net charge has also benefitted from significant provision releases but at lower levels than seen in 2013. The impairment charge in the fourth quarter was £183 million.

Impaired loans as a percentage of closing advances reduced from 6.3 per cent at the end of December 2013 to 2.9 per cent at the end of December 2014, driven by reductions within both the continuing and the Run-off portfolios. Provisions as a percentage of impaired loans increased from 50.1 per cent to 56.4 per cent.

COMPARISON OF EXPECTED LOSSES TO SPECIFIC CREDIT RISK ADJUSTMENTS

The table on page 51 provides a comparison of regulatory expected losses to SCRAs on loans and receivables (impairment provisions and acquisition related fair value adjustments), in respect of credit risk exposures subject to the IRB Approach. The Group does not recognise any general credit risk adjustments (GCRAs) as defined by the EBA.

The definition, calculation and treatment of regulatory expected losses are covered on page 13.

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;

- SCRAs 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 SCRAs outputs is undertaken to ensure that the models adequately capture all incurred losses. Where this is considered not to be the case, additional SCRAs 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 TTC or hybrid 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 21:
Regulatory expected losses

	Regulatory expected losses 2014 £m	Specific credit risk adjustments 2014 £m	Excess expected losses 2014 £m	Regulatory expected losses 2013 £m	Specific credit risk adjustments 2013 £m	Excess expected losses 2013 £m	Regulatory expected losses 2012 £m	Specific credit risk adjustments 2012 £m	Excess expected losses 2012 £m
Credit risk									
Foundation IRB Approach									
Corporates	**1,420**	**1,368**	**52**	4,336	3,823	513	6,910	5,936	974
Central governments and central banks	**1**	**–**	**1**	1	–	1	1	–	1
Institutions	**11**	**21**	**(10)**	8	–	8	5	4	1
Retail IRB Approach									
Residential mortgages	**1,259**	**1,518**	**(259)**	1,967	2,123	(156)	2,270	2,562	(292)
QRRE	**711**	**269**	**442**	911	379	532	1,057	456	601
Other SME	**91**	**22**	**69**	90	26	64	85	20	65
Other non-SME	**465**	**238**	**227**	638	371	267	871	530	341
Other IRB Approaches									
Corporate – specialised lending	**2,288**	**2,237**	**51**	5,805	6,132	(327)	335	215	120
Equities	**31**	**–**	**31**	25	–	25	24	–	24
Counterparty credit risk	**229**	**–**	**229**	488	–	488	139	–	139
	6,506	**5,673**	**833**	14,269	12,854	1,415	11,697	9,723	1,974
Fair value adjustments[1]		**393**			668			702	
Total prior to additional adjustments	**6,506**	**6,066**	**440**	14,269	13,522	747	11,697	10,425	1,272
Other adjustments[2]			**125**			–			–
Total excess expected losses			**565**			747			1,272
Reconciliation of SCRAs to statutory consolidated balance sheet allowance for impairment losses on loans and receivables									
Total SCRAs applied against expected losses			**6,066**			13,522			10,425
SCRAs (excluding fair value adjustments) applied to Standardised Approach and other adjustments[3]			**1,712**			2,329			12,382
Additional fair value and other adjustments			**(1,238)**			(3,760)			(7,348)
Total per statutory consolidated balance sheet			**6,540**			12,091			15,459

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

[2] Other adjustments include an increase for SCRAs in excess of expected loss on defaulted exposures which, under CRD IV may not be offset against non-defaulted excess expected loss, and prudent valuation adjustments.

[3] SCRAs applied to Standardised Approach exposures and other adjustments including allowances for impairment losses on debt securities.

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 123 and 296, respectively, of the 2014 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk continued

Key movements

- Regulatory expected losses for FIRB Corporate reduced from £6.9bn to £4.3bn from 2012 to 2013, primarily as a result of disposals and asset reduction and the transitioning of Foundation Specialised Lending portfolios (primarily Commercial Real Estate) to the IRB Supervisory Slotting approach. The related SCRA reduced from £5.9bn to £3.8bn for similar reasons.
- In 2014, the reduction in FIRB Corporate exposure continued, due to disposals and other reductions in the Run-off portfolio and active portfolio management in the core book. These factors, combined with improved economic conditions resulted in improvements in the quality of the portfolio therefore regulatory expected loss reduced from £4.3bn to £1.4bn and SCRAs reduced from £3.8bn to £1.4bn for similar reasons.
- Under the FIRB Approach a constrained regulatory LGD is applied resulting in a conservative expected loss, particularly for defaulted exposures. The reduction in the defaulted exposures has therefore contributed to the reduction in excess expected loss.
- The Group's mainstream mortgage model includes conservatism as this is based on a TTC probability of default. The Group continues to maintain a prudent provisioning policy over Residential Mortgage portfolios in order to reflect market circumstances. This has resulted in SCRAs exceeding regulatory expected losses for Retail IRB Residential Mortgage portfolios across the last three years.
- The Group's Other Retail IRB portfolios are based on different model methodology, therefore regulatory expected losses remain in excess of related SCRAs, reflecting the impact of model conservatism.
- The reduction in Residential Mortgages IRB expected losses from £1.9bn to £1.3bn is mainly due to the disposal of loans in the Irish mortgage portfolio which has also driven the reduction in SCRAs.
- The Corporate Specialised Lending expected loss and SCRAs increased significantly from 2012 to 2013 reflecting the transitioning of Standardised and FIRB approach Commercial Real Estate portfolios to the Supervisory Slotting approach. The regulatory requirement to apply fixed percentages to calculate expected losses resulted in SCRAs being higher than expected loss in 2013 driven by defaulted exposures in the Irish Commercial Property portfolio.
- During 2014 disposal, write offs and portfolio management activity have reduced the Corporate Specialised Lending portfolio driving an improvement in portfolio credit quality resulting in expected loss reducing from £5.8bn to £2.3bn, and SCRAs from £6.1bn to £2.3bn. The increase in excess expected loss from £0.3bn surplus SCRA to £0.1bn excess expected loss is due to a reduction in defaulted exposures with high levels of SCRAs predominantly in the Irish Commercial Property portfolio.
- Fair value adjustments applied within the excess expected loss calculation have moved from £0.7bn to £0.4bn due to unwind of the fair value adjustment over the course of the year. This is explained further in table 16 on page 46.

ANALYSIS OF CREDIT RISK EXPOSURES BY ASSET CLASS

CREDIT RISK EXPOSURES

The main exposures outlined in this document can be classified and defined as follows:

Central government and central banks exposures

In addition to exposures to central governments and central banks, certain public sector entities and Multilateral Development Banks are also included within this exposure class where they meet the relevant criteria under the CRR provisions.

Institution exposures

These primarily relate 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.

Corporate exposures

In general, this relates to exposures generated through lending and corporate financing activities in respect of servicing the needs of corporate and commercial clients ('Main') and small and medium enterprises (SME). Exposures also arise in relation to business conducted through specialised lending. The 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. Each of these sub-classes is defined under the CRR provisions.

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, which was created specifically to finance and/or operate physical assets;
- 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, major asset financing transactions such as shipping and aircraft (object finance) and energy and infrastructure financing transactions (project finance).

Retail exposures

There are five key categories of retail exposure under CRD IV:

- Retail exposures secured by real estate collateral. These are principally residential mortgages split between retail (non-SME) and SME customers.
- Qualifying revolving retail exposures (QRRE). These relate to overdrafts on personal current accounts and credit cards.
- Other retail exposures (non-SME) represent unsecured personal lending, while 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.

As at 31 December 2014 the total credit risk exposures of the Group amounted to £700.2bn (2013: £724.9bn).

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

Table 22:
Credit risk exposures

Exposure class	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2014 Average credit risk exposure[5] £m
Exposures subject to the IRB approach				
Foundation IRB approach				
Corporate – main	80,496	43,735	54%	83,802
Corporate – SME	13,979	9,637	69%	14,472
Corporate – specialised lending	11	5	42%	87
Central governments and central banks	15,714	1,618	10%	21,393
Institutions	7,970	1,577	20%	6,651
Retail IRB approach				
Retail mortgages	359,326	43,123	12%	362,647
of which: residential mortgages (SME)	11,114	3,174	29%	11,170
of which: residential mortgages (non-SME)	348,212	39,949	11%	351,477
Qualifying revolving retail exposures	36,287	14,061	39%	37,551
Other SME	2,736	1,982	72%	2,827
Other non-SME	14,599	13,720	94%	13,681
Other IRB approaches[1]				
Corporate – specialised lending	22,420	15,821	71%	28,266
Equities – exchange traded	682	1,976	290%	563
Equities – private equity	3,014	5,727	190%	2,930
Equities – other	54	201	370%	96
Securitisation positions[2]	14,351	2,373	17%	13,794
Non-credit obligation assets[3]	8,441	5,047	60%	1,677
Total – IRB approach	580,080	160,603	28%	590,437
Exposures subject to the Standardised Approach				
Central governments and central banks	83,617	11	–	79,221
Regional governments or local authorities	–	–	–	7
Public sector entities	9	9	100%	10
Multilateral development banks	–	–	–	–
Institutions	205	53	26%	790
Corporates	15,490	13,646	88%	16,797
Retail	4,316	2,946	68%	4,555
Secured by mortgages on immovable property	9,575	3,408	36%	8,476
of which: residential property	9,563	3,396	36%	8,426
of which: commercial property	12	12	100%	50
Exposures in default	1,339	1,573	117%	2,117
Exposures associated with particularly high risk	1	1	150%	1
Short term claims on institutions and corporates	–	–	–	259
Collective investment undertakings (CIUs)	–	–	–	14
Other items[3]	5,404	3,797	70%	7,735
Total – standardised approach	119,956	25,444	21%	119,982
Contributions to the default fund of a central counterparty[4]	143	515	360%	101
Total credit risk	700,179	186,562	27%	710,520
Threshold – significant investments	3,324	8,309	250%	3,191

Pillar 1 Capital requirements: Credit risk continued

Exposure class	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2014 Average credit risk exposure[5] £m
Threshold – deferred tax	1,006	2,515	250%	1,346
Total credit risk	**704,509**	**197,386**	**28%**	**715,057**

Exposure class	2013 Credit risk exposure £m	2013 Risk-weighted assets £m	2013 Average risk weight %	2013 Average credit risk exposure[5] £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 mortgages	364,089	52,513	14%	357,822
of which: residential mortgages (SME)	11,151	4,493	40%	10,959
of which: residential mortgages (non-SME)	352,938	48,020	14%	346,863
Qualifying revolving retail exposures	38,352	16,355	43%	37,564
Other SME	2,864	2,600	91%	3,031
Other non-SME	13,391	13,671	102%	13,869
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
Non-credit obligation assets[3]	–	–	–	–
Total – IRB approach	592,468	177,230	30%	599,606
Exposures subject to the Standardised Approach				
Central governments and central banks	78,523	49	–	85,750
Regional governments or local authorities	–	–	–	39
Public sector entities	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 immovable property	7,289	2,741	38%	17,951
of which: residential property	7,098	2,535	36%	13,721
of which: commercial property	191	206	108%	4,230
Exposures at default	2,300	2,742	119%	3,517
Exposures associated with particularly high risk	1	1	150%	1
Short term claims on institutions and corporates	826	830	101%	341
Collective investment undertakings (CIUs)	241	49	20%	255
Other items[3]	18,657	13,437	72%	18,665
Total – standardised approach	132,473	41,150	31%	161,660

Pillar 1 Capital requirements: Credit risk continued

Exposure class	2013 Credit risk exposure £m	2013 Risk-weighted assets £m	2013 Average risk weight %	2013 Average credit risk exposure[5] £m
Contributions to the default fund of a central counterparty[4]	–	–	–	–
Total credit risk	724,941	218,380	30%	761,266
Threshold – significant investments	–	–	–	–
Threshold – deferred tax	–	–	–	–
Total credit risk	724,941	218,380	30%	761,266

[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 IAA and the RBA.

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

[3] Other items (Standardised Approach) and non-credit obligation assets (IRB 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 and sundry debtors.

[4] Previously reported in Institutions under the Standardised Approach following rules applicable at that time (2013: £24m risk-weighted asset).

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

Key movements – IRB

- **FIRB Corporate Main** exposures reduced by £8.3bn during the year to £80.5bn in part due to asset reductions in the Run-off portfolio and active portfolio management in the core book. Risk-weighted assets reduced by £5.0bn to £43.7bn driven by exposure reductions, active portfolio management and methodology refinements. Defaulted exposure reductions, predominantly in the Run-off book, do not reduce risk weighted assets as they are zero weighted under the FIRB approach. Combined with other changes in the portfolio this means that although the credit quality of the Foundation IRB Corporate Main portfolio has improved, the average risk-weight has remained broadly static at 54%.
- **FIRB Corporate SME** exposures reduced by £0.5bn during the year to £14.0bn and risk-weighted assets by £0.9bn to £9.6bn. The risk-weighted asset reduction was primarily driven by methodology updates, particularly the application of the SME scalar, on a portion of the portfolio, as a result of implementation of CRD IV, and resulted in an overall decrease in the average risk weight from 73% to 69%.
- **FIRB Institutions** exposures increased by £2.7bn to £8.0bn, with risk-weighted assets increasing by £0.2bn to £1.6bn resulting in a decrease in the average risk weight from 25% to 20%. This is primarily due to increased lending to higher quality counterparties. The reduction in average risk weight was partially offset by increases arising from the application of Financial Institution Interconnectedness rules, following the implementation of CRD IV.
- **Retail IRB residential mortgage** exposures decreased by £4.8bn to £359.3bn mainly due to the requirement for some TSB exposure to be reported on the Standardised Approach and the sale of loans in the Irish mortgage portfolio, partially offset by asset increases in the core book. Risk-weighted assets reduced by £9.4bn to £43.1bn 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 increased risk-weighted assets arising from updates to models. This results in a decrease in the average risk weight from 14% to 12%. Within the SME sub-category the average risk weight has reduced from 40% to 29% due in part to the application of the SME scalar following the implementation of CRD IV.
- The average risk weights for **Retail IRB qualifying revolving retail** exposures decreased from 43% to 39% primarily as a result of improvements in credit quality reflecting active portfolio management and favourable external economic factors such as reduced unemployment, partially offset by increases arising from model updates. The reduction in exposure is driven by the requirement for TSB to move to a standardised approach in this category, partially offset by growth in the credit card portfolio.
- The average risk weight of **other retail (non SME) exposures** reduced from 102% to 94% as a result of improved risk mix of new business particularly within the Asset Finance business.
- **Other IRB Corporate specialised lending** exposures reduced from £33.2bn to £22.4bn during the year, with a decrease in RWAs from £20.5bn to £15.8bn. The decreases are primary driven by disposals and other reductions in the Run-off portfolio. The average risk-weight increased from 62% to 71% as the exposure reduction is predominantly in the defaulted category which carries a 0% risk weight.
- **Equities – exchange traded** exposure and risk-weighted assets increased by £0.5bn and £1.7bn respectively primarily due to equity received in consideration for the disposal of SWIP.
- **Securitisation positions** have increased by £0.5bn to £14.4bn, with risk-weighted assets reducing from £3.3bn to £2.4bn. The average risk weight has reduced from 24% to 17% due to the downgrade of a securitisation position, moving it to a capital deduction, and a new securitisation in the year with lower risk positions.
- **Non-credit obligation asset** exposure increased by £8.4bn and risk-weighted assets to £5.0bn due to approval being granted by the PRA to reclassify certain asset types from a standardised to IRB approach.

Key movements – Standardised

- **Standardised central governments and central banks'** exposures increased by £5.1bn primarily due to placement of funds with The Bank of England.
- **Standardised Approach Corporates** exposures reduced by £2.9bn during the year, with risk-weighted assets decreasing by £3.3bn to £13.6bn. This is primarily due to asset disposals and repayments in the Run-off portfolio. The reduction in average risk weight is primarily due to application of the SME scalar, where permitted under regulations, following the implementation of CRD IV.
- **Standardised Approach Retail** exposures decreased by £1.0bn to £4.3bn, with risk weighted assets decreasing by £1.1bn to £2.9bn, resulting in a decrease in the average risk weight from 76% to 68%. This was primarily due to the disposal of the 50% stake held in Sainsbury's Bank, with the average risk weight reduction arising from application of the SME scalar following the implementation of CRD IV.
- **Standardised Approach Other items** exposures decreased by £13.2bn to £5.4bn, with risk weighted assets reducing from £13.4bn to £3.8bn. This was primarily as a result of the implementation of CRD IV and the replacement of risk-weighted assets arising from the deferred tax asset with a deduction from CET1. Also contributing is the reclassification of certain items to non-credit obligations as noted above.
- The increase in exposure and risk-weighted assets arising from contributions to the default fund of a CCP reflect the application of CRD IV rules.

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

Table 23:
Divisional credit risk exposures

Division	Risk weight approach	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight £m	2013 Credit risk exposure £m	2013 Risk-weighted assets £m	2013 Average risk weight £m
Retail	IRB	**348,861**	**48,853**	**14%**	345,446	53,044	15%
	Standardised	**8,152**	**4,543**	**56%**	12,742	6,287	49%
Commercial Banking	IRB	**140,242**	**72,608**	**52%**	146,968	83,624	57%
	Standardised	**48,401**	**10,243**	**21%**	49,795	10,787	22%
Consumer Finance	IRB	**35,756**	**15,968**	**45%**	30,318	14,075	46%
	Standardised	**1,856**	**1,365**	**74%**	5,243	2,583	49%
Run-off	IRB	**17,328**	**11,937**	**69%**	35,060	19,337	55%
	Standardised	**4,758**	**3,503**	**74%**	11,335	9,672	85%
TSB	IRB	**18,924**	**3,187**	**17%**	27,437	5,418	20%
	Standardised	**8,921**	**1,980**	**22%**	701	382	54%
Central Items	IRB	**18,969**	**8,050**	**42%**	7,239	1,732	24%
	Standardised	**47,868**	**3,810**	**8%**	52,657	11,439	22%
Total		**700,036**	**186,047**	**27%**	724,941	218,380	30%
Contributions to the default fund of a central counterparty[1]		**143**	**515**	**360%**	–	–	–
Total		**700,179**	**186,562**	**27%**	724,941	218,380	30%

[1] Previously reported in Institutions under exposures subject to the Standardised approach (2013: £24m risk-weighted assets).

Pillar 1 Capital requirements: Credit risk continued

INTERNAL RATING SCALES

Within the Group, PD internal rating scales are used in assessing the credit quality of the FIRB 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

Table 24:
Corporate master scale

	Range			
PD Grades	Lower	Mid	Upper	External S&P Rating (Approximate Equivalent)
1 – 4	0.000%	0.018%	0.035%	AAA to AA-
5	0.036%	0.043%	0.050%	A+
6	0.051%	0.060%	0.080%	A
7	0.081%	0.110%	0.140%	A-
8	0.141%	0.180%	0.220%	BBB+
9	0.221%	0.280%	0.340%	BBB
10	0.341%	0.420%	0.500%	BBB-
11	0.501%	0.630%	0.760%	BB+
12	0.761%	1.000%	1.240%	BB
13	1.241%	1.620%	2.000%	BB-
14	2.001%	2.600%	3.200%	B+
15	3.201%	4.200%	5.200%	B+
16	5.201%	6.200%	7.200%	B
17	7.201%	8.700%	10.200%	B-
18	10.201%	12.000%	13.800%	B-
19	13.801%	31.000%	99.999%	CCC to C
20 – 23 (Default)	100.000%	100.000%	100.000%	Default

Table 25:
Retail master scale

	Range		
PD Grades	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 FIRB and Retail IRB approaches is provided in the sections that follow.

ANALYSIS OF CREDIT RISK EXPOSURES SUBJECT TO THE FIRB APPROACH

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

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

As at 31 December 2014, corporate exposures subject to the FIRB Approach totalled £94.5bn (2013: £103.4bn).

Table 26:
Corporate main exposures by PD grade

PD grades	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	**10,294**	**0.03%**	**21.98%**	11,409	0.03%	22.95%
5	**2,872**	**0.04%**	**23.32%**	3,381	0.04%	29.23%
6	**6,446**	**0.06%**	**25.25%**	7,805	0.07%	29.98%
7	**11,823**	**0.11%**	**31.62%**	11,178	0.11%	34.36%
8	**9,111**	**0.18%**	**46.03%**	11,905	0.17%	45.56%
9	**9,902**	**0.28%**	**56.06%**	8,844	0.27%	59.17%
10	**9,795**	**0.42%**	**66.91%**	9,837	0.43%	73.26%
11	**5,035**	**0.63%**	**75.70%**	4,263	0.67%	88.54%
12	**5,075**	**1.00%**	**94.93%**	4,677	1.06%	103.01%
13	**3,669**	**1.61%**	**103.11%**	3,027	1.69%	120.79%
14	**2,334**	**2.60%**	**130.72%**	1,990	2.69%	126.43%
15	**1,391**	**4.20%**	**133.63%**	289	4.22%	141.15%
16	**905**	**6.20%**	**146.85%**	1,843	5.62%	154.57%
17	**76**	**8.78%**	**191.47%**	133	8.56%	178.33%
18	**28**	**11.75%**	**193.62%**	261	12.87%	214.14%
19	**116**	**26.75%**	**247.67%**	903	31.16%	255.25%
20 – 23 (Default)	**1,624**	**100.00%**	**–**	7,060	100.00%	–
Total	**80,496**	**2.59%**	**54.33%**	88,805	8.78%	54.92%

Key movements

- Exposures reduced by £8.3bn during the year to £80.5bn in part due to asset reductions in the Run-off portfolio and balance sheet management in the core book.
- There was a significant reduction in average PD from 8.78% to 2.59% largely reflecting the reduction in defaulted exposures from £7.0bn to £1.6bn, primarily due to asset reductions in the Run-off portfolio.
- Average risk weights remained relatively static at 54% driven by improvements in credit quality of the book primarily arising from active portfolio management and methodology refinement being substantially offset by reductions in defaulted exposures, carrying zero risk-weighted assets.

Pillar 1 Capital requirements: Credit risk continued

Table 27:
Corporate SME exposures by PD grade

PD grades	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	307	0.03%	20.01%	184	0.03%	21.31%
5	271	0.04%	21.88%	170	0.04%	22.61%
6	364	0.06%	23.42%	733	0.06%	26.77%
7	210	0.11%	28.86%	290	0.11%	28.63%
8	300	0.18%	30.51%	207	0.17%	40.90%
9	500	0.28%	42.71%	571	0.27%	53.20%
10	1,041	0.44%	47.88%	1,211	0.44%	59.40%
11	2,685	0.61%	62.94%	1,921	0.65%	69.62%
12	2,103	1.06%	72.58%	1,866	1.10%	80.32%
13	1,423	1.65%	83.59%	1,388	1.68%	88.98%
14	1,619	2.62%	91.53%	1,837	2.68%	98.73%
15	505	4.16%	95.37%	178	4.07%	87.17%
16	650	5.90%	113.50%	961	5.73%	112.90%
17	247	8.59%	122.28%	172	8.48%	133.92%
18	417	11.27%	143.89%	575	12.14%	154.37%
19	296	29.52%	188.35%	460	26.20%	187.47%
20 – 23 (Default)	1,041	100.00%	–	1,726	100.00%	–
Total	13,979	9.78%	68.94%	14,450	14.58%	73.14%

Key movements

- Corporate SME exposures reduced by £0.5bn during the year to £14.0bn.
- There was a 4.80% reduction in average PD to 9.78% largely as a result of balance sheet management in Commercial Banking which led to a reduction in defaulted and lower quality assets.
- The decrease in the average risk weight from 73.14% to 68.94% was primarily driven by a methodology update for the application of the SME scalar as a result of the implementation of CRD IV.

Table 28:
Corporate specialised lending exposures by PD grade

PD grades	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	–	–	–	–	–	–
5	–	–	–	–	–	–
6	–	–	–	–	–	–
7	–	–	–	–	–	–
8	10	0.20%	31.83%	–	–	
9	–	–	–	1	0.29%	61.97%
10	–	–	–	1	0.45%	100.49%
11	1	0.67%	113.06%	7	0.67%	145.77%
12	–	–	–	16	0.99%	112.35%
13	–	–	–	15	1.39%	131.07%
14	–	–	–	22	2.57%	150.75%
15	–	–	–	14	3.86%	132.86%
16	–	–	–	–	–	–
17	–	–	–	–	–	–
18	–	–	–	–	–	–
19	–	–	–	–	–	–
20 – 23 (Default)	–	–	–	89	100.00%	–
Total	11	1.11%	42.04%	165	55.77%	60.36%

Central government and central bank exposures

As at 31 December 2014, central government and central bank exposures subject to the FIRB Approach totalled £15.7bn (2013: £15.1bn).

Table 29:
Central government and central bank exposures by PD grade

PD grades	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	15,714	0.01%	10.30%	15,015	0.01%	10.43%
5	–	–	–	–	–	–
6	–	–	–	–	–	–
7	–	–	–	48	0.11%	27.42%
8	–	–	–	–	–	–
9	–	–	–	–	–	–
10	–	–	–	–	–	–
11	–	–	–	–	–	–
12	–	–	–	–	–	–
13	–	–	–	–	–	–
14	–	–	–	–	–	–
15	–	–	–	–	–	–
16	–	–	–	–	–	–
17	–	–	–	–	–	–
18	–	–	–	–	–	–
19	–	–	–	–	–	–
20 – 23 (Default)	–	–	–	–	–	–
Total	15,714	0.01%	10.30%	15,063	0.02%	10.48%

Institution exposures

As at 31 December 2014, institution exposures subject to the FIRB Approach totalled £8.0bn (2013: £5.3bn).

Table 30:
Institution exposures by PD grade

PD grades	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	5,579	0.03%	8.30%	1,732	0.03%	6.66%
5	192	0.04%	19.57%	225	0.04%	28.64%
6	591	0.06%	19.20%	799	0.06%	15.05%
7	285	0.11%	21.94%	812	0.11%	24.14%
8	466	0.18%	30.96%	488	0.18%	35.59%
9	178	0.28%	62.71%	161	0.28%	46.96%
10	156	0.45%	69.73%	634	0.45%	32.86%
11	251	0.75%	97.86%	297	0.75%	71.43%
12	175	1.00%	88.24%	115	1.00%	80.39%
13	72	1.62%	169.05%	5	1.63%	93.39%
14	1	2.34%	165.57%	30	2.10%	139.15%
15	5	4.18%	152.99%	3	4.50%	137.10%
16	1	5.84%	192.72%	–	–	–
17	1	8.00%	177.41%	1	8.00%	172.87%
18	–	–	–	–	–	–
19	–	–	–	14	56.61%	202.38%
20 – 23 (Default)	17	100.00%	–	2	100.00%	–
Total	7,970	0.33%	19.78%	5,318	0.39%	25.17%

Key Movements

- FIRB Institutions exposures increased by £2.7bn to £8.0bn largely reflecting increased lending to higher quality counterparties.
- This increase in exposure has been primarily in the highest PD band resulting in a reduction in average PD to 0.33%.
- The decrease in the average risk weight from 25.17% to 19.78% is as a result of increased lending to higher quality counterparties, carrying a lower risk weight partially offset by increases as a result of implementation of the FII Scalar as part of CRD IV methodology changes.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK 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 2014, retail exposures subject to the Retail IRB Approach totalled £412.9bn (2013: £418.7bn).

Table 31:
Residential mortgages (SME) by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Exposure weighted average LGD[1] %	2014 Average risk weight %	2014 Undrawn commitments (gross) £m	2014 Undrawn commitments (post credit conversion factor) £m
0	–	–	–	–	–	–
1	–	–	–	–	–	–
2	**4,387**	**0.62%**	**12.55%**	**11.41%**	**481**	**468**
3	**2,335**	**1.12%**	**13.60%**	**18.34%**	**153**	**149**
4	**1,121**	**1.67%**	**14.14%**	**24.75%**	**70**	**68**
5	**1,116**	**2.62%**	**14.80%**	**32.29%**	**50**	**49**
6	**781**	**5.67%**	**15.31%**	**46.65%**	**34**	**34**
7	**75**	**8.04%**	**21.29%**	**75.01%**	**2**	**2**
8	**519**	**10.61%**	**16.81%**	**68.40%**	**22**	**21**
9	**264**	**18.02%**	**18.62%**	**92.15%**	**8**	**8**
10	–	–	–	–	–	–
11	**108**	**34.10%**	**17.81%**	**99.95%**	**2**	**2**
12	**33**	**78.18%**	**20.08%**	**53.06%**	–	–
Default	**375**	**100.00%**	**6.27%**	**123.48%**	**8**	**8**
Total	**11,114**	**6.22%**	**13.61%**	**28.56%**	**830**	**809**

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) £m	2013 Undrawn commitments (post credit conversion factor) £m
0	–	–	–	–	–	–
1	–	–	–	–	–	–
2	4,234	0.65%	8.85%	14.69%	381	373
3	2,173	1.12%	9.63%	25.14%	154	152
4	1,186	1.67%	9.56%	32.90%	74	73
5	1,184	2.62%	9.71%	43.71%	62	61
6	838	5.67%	10.22%	68.11%	35	35
7	78	8.04%	10.44%	80.50%	3	3
8	582	10.61%	12.48%	107.97%	21	21
9	333	18.02%	14.34%	140.50%	10	10
10	–	–	–	–	–	–
11	149	34.10%	14.25%	147.80%	3	3
12	41	78.18%	18.00%	78.95%	–	–
Default	353	100.00%	5.15%	122.76%	3	3
Total	11,151	6.41%	9.63%	40.29%	746	734

[1] The 10% LGD floor that applies to residential mortgages is applied at portfolio level within this asset class. Whilst the average LGD in certain PD grades and overall is below this level at 2013, these values do not reflect the impact of post model adjustments held at that date in recognition of a revised LGD model calibration requirement. When this element is factored in, the average LGD is above the floor.

Table 32:
Residential mortgages (non-SME) by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Exposure weighted average LGD[1] %	2014 Average risk weight %	2014 Undrawn commitments (gross)[2] £m	2014 Undrawn commitments (post credit conversion factor) £m
0	**157,542**	**0.09%**	**8.96%**	**2.17%**	**6,755**	**6,225**
1	**120,287**	**0.36%**	**10.52%**	**6.90%**	**2,489**	**2,315**
2	**29,697**	**1.00%**	**12.89%**	**17.33%**	**300**	**288**
3	**7,836**	**2.09%**	**13.99%**	**28.51%**	**43**	**40**
4	**11,787**	**3.46%**	**16.08%**	**41.68%**	**172**	**52**
5	**5,585**	**6.51%**	**17.75%**	**63.76%**	**8**	**7**
6	**3,413**	**11.58%**	**16.18%**	**75.87%**	**1**	**1**
7	**1,734**	**16.66%**	**13.55%**	**75.23%**	**–**	**–**
8	**1,201**	**22.70%**	**15.56%**	**91.67%**	**–**	**–**
9	**1,204**	**29.22%**	**14.58%**	**89.90%**	**–**	**–**
10	**1,334**	**40.73%**	**14.21%**	**85.09%**	**–**	**–**
11	**1,112**	**54.47%**	**14.37%**	**75.54%**	**1**	**1**
12	**1,093**	**72.40%**	**15.82%**	**55.83%**	**4**	**4**
Default	**4,387**	**100.00%**	**15.02%**	**84.55%**	**1**	**–**
Total	**348,212**	**2.71%**	**10.60%**	**11.47%**	**9,774**	**8,933**

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%	3,968	3,037
1	134,529	0.27%	10.71%	5.59%	4,360	3,700
2	38,619	0.71%	12.58%	13.27%	477	325
3	19,123	1.29%	13.32%	20.57%	1,610	820
4	12,986	2.59%	14.09%	33.93%	101	13
5	6,005	4.97%	14.82%	52.55%	135	85
6	3,600	9.35%	18.90%	92.87%	6	4
7	2,049	12.75%	18.98%	108.34%	4	1
8	2,022	16.98%	14.31%	84.08%	6	1
9	1,651	22.85%	14.99%	93.99%	4	1
10	2,160	32.05%	14.92%	95.82%	4	1
11	2,134	45.34%	16.14%	95.92%	9	5
12	2,075	68.21%	18.43%	72.25%	5	–
Default	6,568	100.00%	17.75%	106.13%	41	–
Total	352,938	3.57%	10.96%	13.61%	10,730	7,993

[1] The 10 per cent 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 per cent. However, the LGD for the entire sub-portfolio in which these accounts reside is floored at 10 per cent.

[2] Undrawn commitments predominantly relate to pipeline mortgages.

Pillar 1 Capital requirements: Credit risk continued

Table 33:
Residential mortgage exposures by major portfolio

Major portfolio	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Exposure weighted average LGD[1] %	2014 Average risk weight %	2014 Undrawn commitments (gross) £m	2014 Undrawn commitments (post credit conversion factor) £m
UK prime	**266,746**	**2.50%**	**9.68%**	**9.64%**	**7,633**	**7,150**
UK buy-to-let	**53,155**	**1.82%**	**11.85%**	**9.33%**	**1,517**	**1,507**
UK self certified	**19,814**	**6.70%**	**10.41%**	**16.92%**	**479**	**246**
Irish mortgages	**3,666**	**9.15%**	**46.68%**	**124.20%**	**–**	**–**
Dutch mortgages	**4,811**	**2.86%**	**21.40%**	**28.59%**	**145**	**30**
Other mortgages	**11,134**	**6.24%**	**13.66%**	**28.59%**	**830**	**809**
Total	**359,326**	**2.82%**	**10.70%**	**12.00%**	**10,604**	**9,742**

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	270,649	2.93%	9.90%	10.19%	8,484	6,951
UK buy-to-let	50,005	2.44%	13.27%	11.55%	1,693	916
UK self certified	21,527	8.73%	11.01%	23.16%	457	30
Irish mortgages	5,093	24.66%	32.54%	156.70%	–	–
Dutch mortgages	5,325	3.18%	21.93%	27.53%	96	96
Other mortgages	11,490	7.49%	10.67%	41.42%	746	734
Total	364,089	3.66%	10.92%	14.42%	11,476	8,727

[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%.

Key Movements

- UK Prime exposures have reduced largely reflecting the requirement for certain TSB secured exposures to be reported on the Standardised Approach. There have been reductions in average PD reflecting the overall credit quality improvements and favourable macroeconomic conditions.
- UK Buy-to-Let exposures have increased by £3.2bn to £53.2bn reflecting an increase in new lending, which has led to an improved risk mix and a reduction in average PD.
- UK Self Certified exposures have reduced in 2014, reflecting run off of the portfolio which has led to a reduction overall.
- The year-on-year reduction in average LGDs across these portfolios principally reflects the impact of favourable movement in UK house prices in 2014.
- Irish mortgage exposures have reduced to £3.7bn, as a result of the sale of loans in the portfolio, while average PD has decreased as a result of a reduction in defaulted exposures due to this disposal. The movements in LGD are driven by model and methodology changes.
- These movements contributed to a reduction, partially offset by model and methodology changes in the year, in the average risk weight from 14.42% to 12.00%.
- Other mortgages predominantly comprise Commercial Banking loans secured by mortgages on residential property for SMEs. There has been an increase in LGD driven by model and methodology changes and disposal of mortgages in the Run-off portfolio, however this reduction has also driven a reduction in average PD. The average risk weight has fallen from 41% to 29% due in part to the application of the SME scalar following the implementation of CRD IV.
- The difference between undrawn commitments (gross) and undrawn commitments (post credit conversion factor) has decreased due to methodology changes during the year.

Table 34:
Qualifying revolving retail exposures by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Exposure weighted average LGD %	2014 Average risk weight %	2014 Undrawn commitments (gross) £m	2014 Undrawn commitments (post credit conversion factor)[1] £m
0	10,082	0.05%	76.81%	2.76%	14,035	9,622
1	9,258	0.22%	76.58%	9.28%	13,173	7,860
2	4,004	0.58%	78.65%	20.83%	4,570	2,741
3	2,094	0.99%	79.56%	32.07%	1,858	1,200
4	3,632	1.76%	79.63%	49.20%	2,497	1,688
5	2,459	3.38%	79.77%	78.58%	1,150	868
6	1,916	6.03%	79.94%	115.82%	1,035	692
7	822	8.64%	79.82%	144.78%	207	272
8	550	11.61%	79.83%	171.02%	116	123
9	349	16.40%	80.01%	203.61%	61	74
10	196	24.11%	80.15%	237.32%	27	41
11	123	36.04%	79.86%	256.98%	16	23
12	133	66.73%	80.14%	191.20%	10	19
Default	669	100.00%	28.14%	239.98%	41	–
Total	36,287	3.78%	77.05%	38.75%	38,796	25,223

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)[1] £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

[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

– Retail IRB qualifying revolving retail exposures have reduced to £36.3bn driven by the requirement for TSB to move to a standardised approach in this category, partially offset by growth in credit card portfolio.

– The average PD has fallen to 3.78% primarily as a result of improved credit quality reflecting favourable external economic factors such as reduced unemployment.

– The average risk weight has decreased from 42.64% to 38.75% reflecting the improvement in credit quality partially offset by increases arising from model updates.

Pillar 1 Capital requirements: Credit risk continued

Table 35:
Other SME by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Exposure weighted average LGD %	2014 Average risk weight %	2014 Undrawn commitments (gross) £m	2014 Undrawn commitments (post credit conversion factor) £m
0	–	–	–	–	–	–
1	–	–	–	–	–	–
2	**923**	**0.61%**	**63.93%**	**47.92%**	**497**	**497**
3	**444**	**1.12%**	**65.47%**	**67.18%**	**148**	**148**
4	**253**	**1.67%**	**65.86%**	**79.04%**	**63**	**63**
5	**340**	**2.62%**	**67.60%**	**87.81%**	**57**	**57**
6	**179**	**5.67%**	**68.16%**	**98.53%**	**36**	**36**
7	**79**	**8.04%**	**64.89%**	**114.07%**	**6**	**6**
8	**115**	**10.61%**	**71.05%**	**116.17%**	**21**	**21**
9	**50**	**18.02%**	**74.44%**	**152.49%**	**6**	**6**
10	–	–	–	–	–	–
11	**21**	**34.10%**	**75.91%**	**193.41%**	**1**	**1**
12	**11**	**78.18%**	**73.51%**	**111.43%**	**2**	**2**
Default	**321**	**100.00%**	**6.29%**	**66.33%**	**4**	**4**
Total	**2,736**	**14.57%**	**58.98%**	**72.42%**	**841**	**841**

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

Key movements

- The average PD for RIRB Retail Other – SME exposures has reduced from 20.40% to 14.57% as a result of active balance sheet management and credit quality improvements driven by positive economic factors in Commercial Banking.
- The average risk weight has decreased as a result of this improvement as well as the implementation of the SME Scalar as part of methodology changes under CRD IV.

Table 36:
Other non-SME by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Exposure weighted average LGD %	2014 Average risk weight %	2014 Undrawn commitments (gross) £m	2014 Undrawn commitments (post credit conversion factor) £m
0	**124**	**0.08%**	**35.78%**	**8.03%**	**–**	**–**
1	**1,559**	**0.35%**	**45.88%**	**27.47%**	**5**	**2**
2	**1,979**	**0.68%**	**57.97%**	**50.80%**	**10**	**4**
3	**1,169**	**1.01%**	**85.82%**	**92.65%**	**8**	**4**
4	**4,680**	**1.72%**	**68.83%**	**90.02%**	**16**	**7**
5	**2,461**	**3.26%**	**80.36%**	**119.83%**	**10**	**4**
6	**1,222**	**5.86%**	**81.81%**	**130.15%**	**8**	**3**
7	**291**	**8.61%**	**86.53%**	**147.27%**	**2**	**1**
8	**227**	**11.34%**	**80.16%**	**149.70%**	**1**	**1**
9	**109**	**16.98%**	**91.07%**	**200.23%**	**1**	**–**
10	**90**	**22.50%**	**63.76%**	**158.80%**	**–**	**–**
11	**103**	**35.23%**	**49.74%**	**138.67%**	**–**	**–**
12	**102**	**71.55%**	**81.65%**	**155.54%**	**2**	**1**
Default	**483**	**100.00%**	**38.87%**	**208.86%**	**–**	**–**
Total	**14,599**	**6.47%**	**68.64%**	**93.97%**	**63**	**27**

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

Key movements

- RIRB Retail Other – Non-SME exposures have increased by £1.2bn to £14.6bn largely as a result of new lending in Asset Finance.
- This new lending has led to an improved risk mix overall and a reduction in the average PD from 8.95% to 6.47%.
- The reduction in average LGD also reflects an increase in the amount of collateral held against these exposures.
- These movements have combined to give a reduction in the overall average risk weight from 102.09% to 93.97%.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES SUBJECT TO OTHER IRB APPROACHES

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.

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 2014, corporate specialised lending exposures subject to supervisory slotting amounted to £22.4bn (2013: £33.2bn). Risk-weighted assets arising from this amounted to £15.8bn (2013: £20.5bn) as analysed in the table below.

Table 37:
Corporate specialised lending exposures subject to supervisory slotting

Grade	Remaining maturity <2.5 years 2014 Exposure £m	Remaining maturity <2.5 years 2014 Risk-weighted assets £m	Remaining maturity >2.5 years 2014 Exposure £m	Remaining maturity >2.5 years 2014 Risk-weighted assets £m
1) Strong[1]	**2,076**	**1,035**	**4,787**	**2,852**
2) Good	**2,128**	**1,489**	**4,602**	**4,137**
3) Satisfactory	**1,650**	**1,894**	**2,381**	**2,724**
4) Weak	**189**	**472**	**488**	**1,218**
5) Default[2]	**1,753**	**–**	**2,366**	**–**
Total	**7,796**	**4,890**	**14,624**	**10,931**

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[2]	4,919	–	6,859	–
Total	11,861	6,066	21,316	14,445

[1] The average risk weight % in the Strong slotting grade is below the specified regulatory value as a result of exposures to customers which are classed as Strong, typically in the shipping industry, having facilities which have been structured such that the Group also benefits from additional financial collateral from third parties which is not ordinarily part of the security package for Slotting transactions. As a result, recognition of the collateral is applied outside the standard Slotting risk weights, in line with the IRB approach, resulting in a risk weight that is below that ordinarily used in Slotting.

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

Key movements

– Specialised lending exposures decreased from £33.2bn to £22.4bn during the year, with a decrease in risk-weighted assets from £20.5bn to £15.8bn. The decreases are primary driven by reductions within the Run-off business.
– The average risk weight increased from 62% to 71% because the exposure reduction is predominantly in the defaulted category which carries a 0% risk weight.

EQUITY EXPOSURES SUBJECT TO THE SIMPLE RISK WEIGHT METHOD

As at 31 December 2014, total credit risk exposures in respect of equities subject to the Simple Risk Weight Method amounted to £3.8bn (2013: £2.9bn). Risk-weighted assets arising from this amounted to £7.9bn (2013: £5.9bn).

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

Table 38:
Equity exposures subject to the simple risk weight method

	2014 Credit risk exposure £m	2014 Risk-weighted asset £m	2013 Credit risk exposure £m	2013 Risk-weighted asset £m
Privately traded equity exposures – 190%[1]	**3,014**	**5,727**	2,705	5,140
Publicly traded equity exposures – 290%	**682**	**1,976**	106	307
Other equity exposures – 370%	**54**	**201**	123	455
Total	**3,750**	**7,904**	2,934	5,902

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

NON-TRADING BOOK EXPOSURES IN EQUITIES

Non-trading book exposures in equities held by the Group primarily arise within Commercial Banking and Central Items through a combination of individual transactions in the private equity market, debt for equity swaps and strategic equity investments. Private equity investments are generally medium term investments, held for gain and include limited partnership stakes and listed and unlisted equity shares.

The Group's strategic equity investments predominantly comprise an investment in Aberdeen Asset Management plc which was received in consideration for the sale of Scottish Widows Investment Partnership and in support of the strategic asset management relationship established following the sale.

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, 2014 Lloyds Banking Group plc Annual Report and Accounts, page 191

Equity investments (including venture capital), Note 51 (Financial instruments), Notes to the Consolidated Financial Statements, 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 281 to 282

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 43.

The balance sheet value of non-trading book exposures in equities, as at 31 December 2014, is presented in the table below. There was no difference between the balance sheet value and the fair value of these exposures.

Table 39:
Analysis of non-trading book exposures in equities

Equity grouping	2014 Balance sheet value £m	2013 Balance sheet value £m
Publicly quoted equities	**679**	111
Privately held equities	**1,271**	1,058
Total	**1,950**	1,169

Key movements

– The increase in publicly quoted equities predominantly relates to the Group's investment in Aberdeen Asset Management plc. received in consideration for the sale of Scottish Widows Investment Partnership.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES SUBJECT TO THE STANDARDISED APPROACH

As at 31 December 2014, credit risk exposures risk-weighted under the Standardised Approach amounted to £120bn (2013: £132.5bn), generating risk-weighted assets of £25.4bn (2013: £41.2bn) and a capital requirement of £2bn (2013: £3.3bn).

Central governments and central banks

Table 40:
Standardised central government and central bank exposures by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
0%	**83,606**	**–**	**83,606**	**–**
100%	**11**	**–**	**11**	**11**
Total	**83,617**	**–**	**83,617**	**11**

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

Public sector entities

Table 41:
Standardised public sector entities by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
100%	**9**	**–**	**9**	**9**
Total	**9**	**–**	**9**	**9**

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%	9	–	9	9
Total	9	–	9	9

Institutions

Table 42:
Standardised institution exposures by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
20%	**167**	**–**	**167**	**34**
50%	**38**	**–**	**38**	**19**
100%	**–**	**–**	**–**	**–**
Total	**205**	**–**	**205**	**53**

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%	677	–	677	135
50%	222	–	222	111
100%	49	–	49	49
Total	948	–	948	295

Corporates

Table 43:
Standardised corporate exposures by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset[1] £m
20%	**241**	**–**	**241**	**48**
50%	**1,495**	**–**	**1,495**	**748**
100%	**13,750**	**(395)**	**13,355**	**12,845**
150%	**4**	**–**	**4**	**5**
Other[2]	**–**	**–**	**–**	**–**
Total	**15,490**	**(395)**	**15,095**	**13,646**

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%	161	–	161	32
50%	1,342	–	1,342	671
100%	9,341	(7)	9,334	9,334
150%	–	–	–	–
Other[2]	7,510	(1,262)	6,248	6,937
Total	18,354	(1,269)	17,085	16,974

[1] RWAs at 31 December 2014 are calculated after the application of the SME scalar, in accordance with CRD IV requirements.

[2] During the year exposures within the other risk weight category reduced from £7.5bn to nil, with risk-weighted assets from £6.9bn to nil. This was due to a reallocation of exposures following appropriate system changes which have resulted in the ability to reallocate last year's additional conservative estimates.

Pillar 1 Capital requirements: Credit risk continued

Retail

Table 44:
Standardised retail exposures by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset[1] £m
75%	**4,316**	**–**	**4,316**	**2,946**
100%	**–**	**–**	**–**	**–**
150%	**–**	**–**	**–**	**–**
Total	**4,316**	**–**	**4,316**	**2,946**

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
75%	5,220	–	5,220	3,915
100%	98	–	98	98
150%	7	–	7	10
Total	5,325	–	5,325	4,023

[1] RWAs at 31 December 2014 are calculated after the application of the SME scalar, in accordance with CRD IV requirements.

Secured by mortgages on residential property

Table 45:
Standardised secured by mortgages on residential property by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset[1] £m
35%	**9,265**	**–**	**9,265**	**3,244**
50%	**293**	**–**	**293**	**147**
100%	**5**	**–**	**5**	**5**
Total	**9,563**	**–**	**9,563**	**3,396**

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
35%	6,759	–	6,759	2,365
50%	339	–	339	170
100%	–	–	–	–
Total	7,098	–	7,098	2,535

[1] RWAs at 31 December 2014 are calculated after the application of the SME scalar, in accordance with CRD IV requirements.

Secured by mortgages on commercial real estate

Table 46:
Standardised secured by mortgages on commercial real estate by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
100%	12	–	12	12
150%	–	–	–	–
Total	12	–	12	12

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
Total	191	–	191	206

Exposures in default

Table 47:
Standardised exposures in default by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
35%	–	–	–	–
50%	–	–	–	–
100%	866	–	866	866
150%	473	(2)	471	707
Total	1,339	(2)	1,337	1,573

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
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

Pillar 1 Capital requirements: Credit risk continued

Items belonging to regulatory high risk categories

Table 48:
Standardised items belonging to regulatory high risk categories by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
150%	1	–	1	1
Total	**1**	**–**	**1**	**1**

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

Short term claims on institutions and corporates

Table 49:
Standardised short term claims on institutions and corporates by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
100%	–	–	–	–
150%	–	–	–	–
Total	**–**	**–**	**–**	**–**

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

Collective investment undertakings

Table 50:
Standardised collective investment undertaking exposures by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
20%	–	–	–	–
Total	**–**	**–**	**–**	**–**

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
Total	241	–	241	49

Other items

Table 51: Standardised other items by risk weight

Risk weight	2014 Credit risk exposure (pre CRM) £m	2014 Credit risk mitigation £m	2014 Credit risk exposure (post CRM) £m	2014 Risk-weighted asset £m
0%	580	–	580	–
20%	1,283	–	1,283	256
100%	3,541	–	3,541	3,541
Other[1]	–	–	–	–
Total	5,404	–	5,404	3,797

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

[1] In 2013 Other included residual values of operating lease assets that were subject to non-standard risk-weights. In 2014, these assets are now reported as non-credit obligations on the IRB approach.

Key movements

– Standardised other items exposures reduced from £18.7bn to £5.4bn, and corresponding RWAs from £13.4bn to £3.8bn, primarily as a result of the implementation of CRD IV and the threshold treatment for the deferred tax asset. In addition, during the year the PRA granted approval to reclassify certain non-credit obligations from other items under the standardised approach to non-credit obligations under the IRB approach.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES BY INDUSTRY

Credit risk exposures as at 31 December 2014, analysed by major industrial sector, are provided in the table below.

Table 52:
Credit risk exposures analysed by major industrial sector

	2014 Agriculture, forestry and fishing £m	2014 Energy and water supply £m	2014 Manufacturing £m	2014 Construction £m	2014 Transport, distribution and hotels £m	2014 Postal and comms £m	2014 Property companies £m	2014 Financial, business and other services £m	2014 Personal: mortgages £m	2014 Personal: Other £m	2014 Lease financing £m	2014 Hire purchase £m	2014 Total £m
Exposures subject to the IRB approach													
Foundation IRB approach													
Corporate – main	172	3,761	11,921	2,949	12,396	2,511	10,764	31,467	–	3	2,617	1,935	80,496
Corporate – SME	1,237	20	1,458	491	3,018	46	3,053	4,356	–	–	1	299	13,979
Corporate – specialised lending	–	–	–	–	10	–	1	–	–	–	–	–	11
Central governments and central banks	–	–	–	–	–	–	–	15,714	–	–	–	–	15,714
Institutions	–	10	–	8	–	–	–	7,770	–	–	142	40	7,970
Retail IRB approach													
Retail mortgages	1,544	6	358	377	1,953	38	4,820	2,016	348,212	2	–	–	359,326
of which: residential mortgages (SME)	1,544	6	358	377	1,953	38	4,820	2,016	–	2	–	–	11,114
of which: residential mortgages (non-SME)	–	–	–	–	–	–	–	–	348,212	–	–	–	348,212
Qualifying revolving retail exposures	–	–	–	–	–	–	–	–	–	36,287	–	–	36,287
Other SME	227	3	208	313	638	17	416	910	–	4	–	–	2,736
Other non-SME	–	–	–	–	–	–	–	–	–	9,846	–	4,753	14,599
Other IRB approaches													
Corporate – specialised lending	2	902	333	591	1,574	8	14,793	3,604	–	–	613	–	22,420
Equities – exchange traded	–	–	–	–	–	–	–	682	–	–	–	–	682
Equities – private equity	–	92	333	150	420	597	390	1,032	–	–	–	–	3,014
Equities – other	–	–	–	–	–	–	–	54	–	–	–	–	54
Securitisation positions	–	–	–	–	–	–	–	14,351	–	–	–	–	14,351
Total – IRB approach	3,182	4,794	14,611	4,879	20,009	3,217	34,237	81,956	348,212	46,142	3,373	7,027	571,639
Exposures subject to the standardised approach													
Central governments and central banks	–	–	–	–	–	–	–	83,616	–	–	–	1	83,617
Public sector entities	–	–	–	–	–	–	–	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–	–	–	–	–	–	–	–
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	–	–	159	41	–	5	–	205
Corporates	2,370	389	1,153	229	2,651	96	1,664	6,229	3	337	313	56	15,490
Retail	1,515	–	5	26	61	–	68	84	942	1,420	–	195	4,316
Secured by mortgages on immovable property	4	–	1	5	13	–	24	191	9,336	1	–	–	9,575
of which: residential property	4	–	1	5	13	–	24	179	9,336	1	–	–	9,563
of which: commercial property	–	–	–	–	–	–	–	12	–	–	–	–	12
Exposures in default	11	1	28	33	160	–	310	201	521	68	3	3	1,339
Exposures associated with particularly high risk	–	–	–	–	–	–	1	–	–	–	–	–	1
Short term claims on institutions and corporates	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–	–	–	–	–	–	–	–
Total – standardised approach	3,900	390	1,187	293	2,885	96	2,067	90,489	10,843	1,826	321	255	114,552
Total	7,082	5,184	15,798	5,172	22,894	3,313	36,304	172,445	359,055	47,968	3,694	7,282	686,191
Other items													5,404
Non-credit obligation assets													8,441
Contributions to the default fund of a central counterparty													143
Total credit risk exposure													700,179

	2013 Agriculture, forestry and fishing £m	2013 Energy and water supply £m	2013 Manufacturing £m	2013 Construction £m	2013 Transport, distribution and hotels £m	2013 Postal and comms £m	2013 Property companies £m	2013 Financial, business and other services £m	2013 Personal: mortgages £m	2013 Personal: Other £m	2013 Lease financing £m	2013 Hire purchase £m	2013 Total £m
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 mortgages	1,457	6	341	374	1,956	40	4,369	2,703	352,841	2	–	–	364,089
of which: residential mortgages (SME)	1,457	6	341	374	1,956	40	4,369	2,607	–	1	–	–	11,151
of which: residential mortgages (non-SME)	–	–	–	–	–	–	–	96	352,841	1	–	–	352,938
Qualifying revolving retail exposures	–	–	–	–	–	–	–	–	–	38,352	–	–	38,352
Other SME	327	3	240	387	848	24	607	423	–	5	–	–	2,864
Other non-SME	–	–	–	–	–	–	–	–	–	10,016	–	3,375	13,391
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
Public sector entities	–	–	–	–	–	–	–	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–	–	–	–	–	–	–	–
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–
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 immovable property	1	–	2	3	9	–	145	31	7,098	–	–	–	7,289
of which: residential property	–	–	–	–	–	–	–	–	7,098	–	–	–	7,098
of which: commercial property	1	–	2	3	9	–	145	31	–	–	–	–	191
Exposures in default	13	7	99	31	578	–	245	437	746	142	–	2	2,300
Exposures associated with particularly high risk	–	–	–	–	–	–	1	–	–	–	–	–	1
Short term claims on institutions and corporates	–	–	21	–	13	–	11	780	–	1	–	–	826
Collective investment undertakings (CIUs)	–	–	–	–	–	–	–	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
Non-credit obligation assets													–
Contributions to the default fund of a central counterparty													–
Total credit risk exposure													724,941

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES BY GEOGRAPHY

Credit risk exposures as at 31 December 2014, analysed by geographical region, based on the country of residence of the customer, are provided in the table below.

Table 53:
Credit risk exposures analysed by geographical region

	2014 United Kingdom £m	2014 Rest of Europe £m	2014 United States of America £m	2014 Asia-Pacific £m	2014 Other £m	2014 Total £m
Exposures subject to the IRB approach						
Foundation IRB approach						
Corporate – main	60,028	9,359	8,620	690	1,799	80,496
Corporate – SME	13,912	27	–	22	18	13,979
Corporate – specialised lending	1	–	–	–	10	11
Central governments and central banks	–	2	15,629	–	83	15,714
Institutions	2,442	3,567	989	262	710	7,970
Retail IRB approach						
Retail mortgages	350,823	8,498	–	1	4	359,326
of which: residential mortgages (SME)	11,105	4	–	1	4	11,114
of which: residential mortgages (non-SME)	339,718	8,494	–	–	–	348,212
Qualifying revolving retail exposures	36,287	–	–	–	–	36,287
Other SME	2,735	–	–	–	1	2,736
Other non-SME	14,519	80	–	–	–	14,599
Other IRB approaches						
Corporate – specialised lending	15,730	5,003	484	238	965	22,420
Equities – exchange traded	570	112	–	–	–	682
Equities – private equity	2,765	102	89	17	41	3,014
Equities – other	45	9	–	–	–	54
Securitisation positions[1]	9,973	807	3,571	–	–	14,351
Total – IRB approach	509,830	27,566	29,382	1,230	3,631	571,639
Exposures subject to the standardised approach						
Central governments and central banks	76,458	6,925	211	14	9	83,617
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	50	71	58	26	–	205
Corporates	10,254	2,436	1,367	403	1,030	15,490
Retail	3,419	889	1	5	2	4,316
Secured by mortgages on immovable property	8,348	312	109	620	186	9,575
of which: residential property	8,348	300	109	620	186	9,563
of which: commercial property	–	12	–	–	–	12
Exposures in default	894	366	21	24	34	1,339
Exposures associated with particularly high risk	1	–	–	–	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–
Total – standardised approach	99,433	10,999	1,767	1,092	1,261	114,552
Total	609,263	38,565	31,149	2,322	4,892	686,191
Other items						5,404
Non-credit obligation assets						8,441
Contributions to the default fund of a central counterparty						143
Total credit risk exposure						700,179

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

	2013 United Kingdom £m	2013 Rest of Europe £m	2013 United States of America £m	2013 Asia-Pacific £m	2013 Other £m	2013 Total £m
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 mortgages	353,653	10,436	–	–	–	364,089
of which: residential mortgages (SME)	11,151	–	–	–	–	11,151
of which: residential mortgages (non-SME)	342,502	10,436	–	–	–	352,938
Qualifying revolving retail exposures	38,352	–	–	–	–	38,352
Other SME	2,864	–	–	–	–	2,864
Other non-SME	13,316	75	–	–	–	13,391
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	–	–	–	–	–	–
Public sector entities	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
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 immovable property	5,797	424	115	735	218	7,289
of which: residential property	5,691	340	115	735	217	7,098
of which: commercial property	106	84	–	–	1	191
Exposures in default	927	1,058	66	197	52	2,300
Exposures associated with particularly high risk	1	–	–	–	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	28	35	9	–	754	826
Collective investment undertakings (CIUs)	241	–	–	–	–	241
Equity exposures	–	–	–	–	–	–
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
Non-credit obligation assets						–
Contributions to the default fund of a central counterparty						–
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.

Pillar 1 Capital requirements: Credit risk continued

Table 54:
Exposures subject to the IRB approach analysed by geographical region

	2014 United Kingdom			2014 Rest of Europe			2014 United States of America			2014 Asia-Pacific			2014 Other			2014 Total		
	EAD £m	LGD %	PD %	EAD £m	LGD %	PD %	EAD £m	LGD %	PD %	EAD £m	LGD %	PD %	EAD £m	LGD %	PD %	EAD £m	LGD %	PD %
Exposures subject to the IRB Approach																		
Foundation IRB Approach																		
Corporate – main	60,028		3.30%	9,359		0.84%	8,620		0.23%	690		0.39%	1,799		0.28%	80,496		2.59%
Corporate – SME	13,912		9.82%	27		3.97%	–		–	22		1.00%	18		4.25%	13,979		9.78%
Corporate – specialised lending	1		7.17%	–		–	–		–	–		–	10		0.20%	11		1.11%
Central governments and central banks	–		–	2		0.01%	15,629		0.01%	–		–	83		0.02%	15,714		0.01%
Institutions	2,442		0.82%	3,567		0.12%	989		0.06%	262		0.13%	710		0.13%	7,970		0.33%
Total – Foundation IRB Approach	76,383		4.41%	12,955		0.65%	25,238		0.09%	974		0.33%	2,620		0.26%	118,172		2.95%
Retail IRB Approach																		
Retail mortgages	350,823	10.17%	2.75%	8,498	32.34%	5.57%	–	–	–	1	6.73%	1.35%	4	17.18%	2.26%	359,326	10.70%	2.82%
of which: residential mortgages (SME)	11,105	13.61%	6.23%	4	8.34%	1.74%	–	–	–	1	6.73%	1.35%	4	17.18%	2.26%	11,114	13.61%	6.22%
of which: residential mortgages (Non-SME)	339,718	10.06%	2.64%	8,494	32.35%	5.57%	–	–	–	–	–	–	–	–	–	348,212	10.60%	2.71%
Qualifying revolving retail exposures	36,287	77.05%	3.78%	–	–	–	–	–	–	–	–	–	–	–	–	36,287	77.05%	3.78%
Other SME	2,735	58.98%	14.57%	–	–	–	–	–	–	–	–	–	1	57.20%	5.95%	2,736	58.98%	14.57%
Other non-SME	14,519	68.69%	6.49%	80	59.91%	2.55%	–	–	–	–	–	–	–	–	–	14,599	68.64%	6.47%
Total – Retail IRB Approach	404,364	18.61%	3.06%	8,578	32.59%	5.54%	–	–	–	1	6.73%	1.35%	5	26.40%	4.11%	412,948	18.90%	3.11%

ANALYSIS OF CREDIT RISK EXPOSURES BY RESIDUAL MATURITY

Credit risk exposures as at 31 December 2014, analysed by residual contractual maturity, are provided in the table below.

Table 55:
Credit risk exposures analysed by residual contractual maturity

	2014 On demand £m	2014 Repayable in 3 months or less £m	2014 Repayable between 3 months and 1 year £m	2014 Repayable between 1 and 5 years £m	2014 Repayable over 5 years or undated £m	2014 Total £m
Exposures subject to the IRB approach						
Foundation IRB approach						
Corporate – main	5,738	5,001	16,684	40,977	12,096	80,496
Corporate – SME	1,030	636	3,475	3,264	5,574	13,979
Corporate – specialised lending	10	–	–	–	1	11
Central governments and central banks	–	8,638	909	951	5,216	15,714
Institutions	243	725	1,950	3,200	1,852	7,970
Retail IRB approach						
Retail mortgages	1,147	1,203	11,191	21,172	324,613	359,326
of which: residential mortgages (SME)	317	549	965	1,463	7,820	11,114
of which: residential mortgages (non-SME)	830	654	10,226	19,709	316,793	348,212
Qualifying revolving retail exposures	36,287	–	–	–	–	36,287
Other SME	142	352	759	378	1,105	2,736
Other non-SME	74	265	1,260	11,727	1,273	14,599
Other IRB approaches						
Corporate – specialised lending	361	1,177	2,091	10,098	8,693	22,420
Equities – exchange traded	–	–	–	–	682	682
Equities – private equity	–	112	398	2,167	337	3,014
Equities – other	–	–	2	7	45	54
Securitisation positions	–	1,019	8,007	1,609	3,716	14,351
Total – IRB approach	45,032	19,128	46,726	95,550	365,203	571,639
Exposures subject to the standardised approach						
Central governments and central banks	34,382	5,999	54	3,812	39,370	83,617
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	–	–	–	8	1	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	38	104	59	4	–	205
Corporates	1,190	375	1,627	3,962	8,336	15,490
Retail	1,055	24	97	703	2,437	4,316
Secured by mortgages on immovable property	680	44	129	835	7,887	9,575
of which: residential property	680	44	129	823	7,887	9,563
of which: commercial property	–	–	–	12	–	12
Exposures in default	238	42	91	251	717	1,339
Exposures associated with particularly high risk	–	–	–	1	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–
Total – standardised approach	37,583	6,588	2,057	9,576	58,748	114,552
Total	82,615	25,716	48,783	105,126	423,951	686,191
Other items						5,404
Non-credit obligation assets						8,441
Contributions to the default fund of a central counterparty						143
Total credit risk exposure						700,179

Pillar 1 Capital requirements: Credit risk continued

	2013 On demand £m	2013 Repayable in 3 months or less £m	2013 Repayable between 3 months and 1 year £m	2013 Repayable between 1 and 5 years £m	2013 Repayable over 5 years or undated £m	2013 Total £m
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 mortgages	1,218	1,468	9,769	21,578	330,056	364,089
of which: residential mortgages (SME)	345	544	909	1,328	8,025	11,151
of which: residential mortgages (non-SME)	873	924	8,860	20,250	322,031	352,938
Qualifying revolving retail exposures	38,352	–	–	–	–	38,352
Other SME	264	419	803	479	899	2,864
Other non-SME	157	82	592	10,539	2,021	13,391
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	–	–	–	–	–	–
Public sector entities	–	–	–	–	9	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
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 immovable property	663	32	91	581	5,922	7,289
of which: residential property	662	26	81	466	5,863	7,098
of which: commercial property	1	6	10	115	59	191
Exposures in default	151	55	344	464	1,286	2,300
Exposures associated with particularly high risk	–	–	–	–	1	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	37	789	–	–	–	826
Collective investment undertakings (CIUs)	241	–	–	–	–	241
Equity exposures	–	–	–	–	–	–
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
Non-credit obligation assets						–
Contributions to the default fund of a central counterparty						–
Total credit risk exposure						724,941

Pillar 1 Capital requirements: Credit risk – securitisation

This section details Lloyds Banking Group's securitisation profile.

This focuses on:

- The Group's role in the securitisation market,
- The risk-weighted approaches applied, and
- The exposures, risk-weighted assets and associated capital requirements for each securitisation type.

Pillar 1 Capital requirements: Credit risk – securitisation continued

The Group is an active participant in the securitisation market, operating as an originator, a sponsor of Asset Backed Commercial Paper (ABCP) 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's objectives in relation to securitisation are to manage risk concentrations in its balance sheet, to support relationships with customers and to manage its funding requirements and capital position. It undertakes the following roles to meet these objectives:

As an originator the Group makes use of securitisation as a means of actively managing its balance sheet. Securitisation is primarily used as a funding tool, however it can be used to generate capital efficiency through the use of synthetic commercial loan securitisations which involve the use of CDS. In capital efficient transactions a test of significant risk transfer (SRT) is applied, and when it is met, the capital required on the underlying exposures is replaced by the lower capital requirements of the retained positions in the securitisation, which are then risk-weighted using the Ratings Based Approach. Origination activities mainly extend around the Group's retail and commercial lending portfolios. Further details on the Group's originated securitisations are provided on pages 86 to 88.

As a sponsor the Group manages and supports, through the provision of liquidity facilities, an ABCP conduit (Cancara). It also holds some Commercial Paper (CP) issued by Cancara. The Group sponsors two further asset-backed conduits, which are being run down. They have no commercial paper in issue and no external liquidity providers. Liquidity facilities provided to Cancara are risk-weighted using the IAA. Further details can be found on pages 89 to 91.

As an investor the Group invests directly in third party asset backed securities and provides liquidity facilities to other third party securitisations. Invested Securitisations are risk-weighted using the RBA. Further details can be found on pages 91 to 93.

Summary analysis

As at 31 December 2014, credit risk exposures classed as securitisation positions amounted to £14.4bn (2013: £13.9bn). 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 56:
Summary of non-trading book securitisation exposures and capital requirements

Securitisation type and risk weight approach	2014 Credit risk exposure[1] £m	2014 Risk-weighted assets[2] £m	2014 Capital requirement £m	2014 Deduction from capital[3,5] £m
Originated:				
Ratings based approach	**1,974**	**284**	**23**	**13**
Sponsored and invested:				
Internal assessment approach	**7,351**	**725**	**58**	**–**
Ratings based approach	**5,026**	**1,364**	**109**	**56**
Total[4]	**14,351**	**2,373**	**190**	**69**

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

[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 SCRAs 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 SCRAs.

[4] Excludes counterparty credit risk securitisation positions, further information on which can be found on page 98.

[5] An additional £142m (2013: £74m) 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 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. This means the 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, 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.

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.

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.

Synthetic originated securitisations work in a similar way to the traditional version , except that the legal ownership of the underlying assets remains with the bank. The economic risk of the assets is transferred instead using CDS. 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 2014 the Group has no remaining originated re-securitisation positions.

Summary of accounting policies

From an accounting perspective, the treatment of SEs is assessed in accordance with 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 the Group assets to an SE that it controls fails the 'derecognition' accounting tests under International Accounting Standard (IAS) 39. 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 financing arrangements.

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 2014 Lloyds Banking Group plc Annual Report and Accounts.

The Group's retained and purchased securitisation positions are valued for accounting purposes in accordance with the Group's accounting policies as outlined on pages 190 to 192 (Financial Assets and Liabilities) of the 2014 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 277 to 278 (Fair Value Measurement) of the 2014 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk – securitisation continued

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 57:
Securitisation programmes

Securitisation Programmes[1]	**2014 Gross assets securitised £m**	2013 Gross assets securitised £m	Movement £m	**2014 Notes in issue £m**	2013 Notes in issue £m	Movement £m
UK residential mortgages	**50,250**	55,998	(5,748)	**28,392**	36,286	(7,894)
Commercial loans	**13,372**	10,931	2,441	**12,533**	11,259	1,274
Credit card receivables	**6,762**	6,314	448	**4,278**	3,992	286
Dutch residential mortgages	**3,866**	4,381	(515)	**4,004**	4,508	(504)
Personal loans	**1,318**	2,729	(1,411)	**751**	750	1
PFI/PPP and project finance loans	**402**	525	(123)	**99**	106	(7)
	75,970	80,878	(4,908)	**50,057**	56,901	(6,844)
Less notes held by the Group				**(38,149)**	(38,288)	
Total				**11,908**	18,613	

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

Gross assets securitised reduced by £4.9bn during the year, mainly reflecting reductions across the UK residential mortgage programmes, with no new issuances to replace repayments made during the year. The reduction in gross assets securitised was partially offset by the commencement of a new synthetic commercial loans securitisation.

No securitisation transactions undertaken during the year were recognised as sales (2013: nil).

Risks inherent in securitised assets

Where the Group acts as originator, its securitisation programmes primarily includes 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.

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. Meeting this test allows the retained positions in the securitisations to be included within regulatory calculations, and the RWAs on the assets underlying the securitisation to be removed. 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.

The Group's securitisation programmes are predominantly funding transactions, including all of the residential mortgage programmes. Details on the commercial loans, PFI/PPP and project finance loan programmes that meet significant risk transfer requirements are presented on pages 87-88.

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 £2.2bn (2013: £0.9bn) 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 58:
Analysis of gross securitised exposures on a regulatory basis

	Gross securitised exposure			
	2014 Synthetic £m	2014 Impaired exposures £m	2014 Past due but not impaired exposures £m	2014 SCRAs £m
Commercial, PFI/PPP and project finance loans	**2,174**	**52**	**–**	**16**
Total	**2,174**	**52**	**–**	**16**

	Gross securitised exposure			
	2013 Synthetic £m	2013 Impaired exposures £m	2013 Past due but not impaired exposures £m	2013 SCRAs £m
Commercial, PFI/PPP and project finance loans	945	45	–	14
Total	945	45	–	14

Key movements

- Gross securitised exposures increased by £1.2bn during the year, primarily as a result of the commencement of a new synthetic commercial loan securitisation.
- The net charge to the income statement for the year to 31 December 2014 in respect of losses attributed to the gross securitised exposures noted above amounted to £6m (2013: £2m).

Pillar 1 Capital requirements: Credit risk – securitisation continued

Originated securitisations subject to the Ratings Based Approach

The RBA utilises a set of defined risk weights prescribed by CRD IV rules. 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 2014, securitisation positions arising from origination activities and risk-weighted under the RBA amounted to £2bn (2013: £0.6bn), generating a capital requirement of £23m (2013: £5m). The Group had no originated re-securitisation positions in 2014 or 2013. An analysis of these positions, by risk weight category, is provided in the table below.

Table 59:
Analysis of originated positions by risk weight category

		Securitisation Positions				Total 2014		Total 2013	
		Senior		Non-senior					
S&P Equivalent Rating and RBA Risk Weight[1]		Exposure £m	Cap req £m	Exposure £m	Cap req £m	Exposure £m	Cap req £m	Exposure £m	Cap req £m
AAA	(7%, 12%)	1,192	7	62	1	1,254	8	191	1
AA	(8%, 15%)	–	–	78	1	78	1	380	3
A+	(10%, 18%)	–	–	187	3	187	3	–	–
A	(12%, 20%)	299	3	56	1	355	4	24	–
A-	(20%, 35%)	–	–	–	–	–	–	–	–
BBB+	(35%, 50%)	–	–	39	2	39	2	–	–
BBB	(60%, 75%)	–	–	56	3	56	3	4	–
BBB-	(100%, 100%)	–	–	–	–	–	–	–	–
BB+	(250%, 250%)	–	–	–	–	–	–	–	–
BB	(425%, 425%)	–	–	5	2	5	2	1	1
BB-	(650%, 650%)	–	–	–	–	–	–	–	–
Below BB- or unrated	Deduction	–	–	29	–	29	–	27	–
Total		1,491	10	512	13	2,003	23	627	5
SCRAs taken to reserves[2]						(16)	–	(14)	–
Deduction from capital						(13)	–	(13)	–
Total credit risk exposure/capital requirement[3]						1,974	23	600	5

[1] The RBA risk weights for each rating are listed in the following order: senior securitisation positions, non-senior securitisation positions. Positions rated below BB- or that are unrated are deducted from capital, net of SCRAs applied.

[2] SCRAs 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 SCRAs, where applicable. All retained positions are held on-balance sheet.

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 CDS's to securitise, in combination with external funding, commercial, PFI/PPP and project finance loans. The CDS offer credit protection to the Group over the positions referenced in the synthetic securitisation programmes. The CDSs are collateralised, through the issuance of credit linked notes. Counterparties include other institutions and professional investors.

The Group does not typically make use of hedging against securitisation positions.

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 2014, £41m of the facility had been drawn down (2013 £14m).

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 LTV mortgage being made. In accordance with the regulatory treatment proposed by the PRA, the benefit of the scheme may require a securitisation treatment and it is therefore anticipated that amounts extended under this scheme may be securitised. As at 31 December 2014, £1,950m (2013 £79m) had been extended under the scheme. Further details on the scheme are provided on page 270 of the 2014 Lloyds Banking Group plc Annual Report & Accounts.

SPONSORED AND INVESTED SECURITISATIONS

Asset-backed conduits

The Group sponsors an ABCP conduit (Cancara) that invests in client receivables and debt securities. The conduit structure consist of a series of bankruptcy remote SEs that purchase receivables and are funded either by the issue of ABCP or through the provision of liquidity facilities. The structures generate fee income and net interest income for the Group.

In addition, the Group sponsors two further asset-backed conduits which are being run down. These asset backed conduits have no commercial paper in issue and no external liquidity providers. The capital requirements are assessed by looking through to the underlying asset portfolio held. As a result the liquidity and repurchase facilities do not attract capital.

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 60:
Conduit assets

	2014 Cancara £m
Loans and advances	**4,605**
Debt securities classified as loans and receivables:	
Asset backed securities	**640**
Total assets	**5,245**

	2013 Cancara £m
Loans and advances	4,781
Debt securities classified as loans and receivables:	
Asset backed securities	300
Total assets	5,081

Cancara – summary of activity

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 ABCP.
Programme limit/CP outstanding as at 31 December 2014	\$20.0bn/\$8.2bn (£12.8bn/£5.3bn)
Conduit structure	Fully supported multi-seller
Credit enhancement	Programme wide letter of credit and full support liquidity
Liquidity provider	Lloyds Bank Plc and Bank of Scotland Plc

Structure and liquidity facilities

Cancara Asset Securitisation Limited is an ABCP conduit that buys assets from clients of the Group. 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 CP with Cancara Asset Securitisation Limited.

Assets purchased relate to pools of third party receivables.

A number of intermediary special purpose entities within the conduit structure are used to purchase the assets. Each purchasing company enters into a commissioning 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.

For each new asset purchase, Cancara enters into a liquidity facility with the Group, to cover 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, the liquidity facility should not require to be drawn down upon under normal circumstances.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Capital assessment

With regard to Cancara, the Group has approval to utilise the Internal Assessment Approach (IAA) for calculating capital requirements for the liquidity facilities provided to the conduit purchasing companies.

The Group's IAA model is a proprietary credit rating system. This model generates a rating equivalent to an external rating. This rating will then feed the Ratings Based Approach in order to calculate the capital requirement.

The model consists of a number of scorecards, one for each asset class. Unlike the Group's Foundation and Retail IRB models, the ABCP IAA 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 grade. The internal rating methodology must reflect the ECAI's methodology. 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 IAA 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 significant 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 CRR (Article 259) which establishes the criteria that must be met in order to apply the IAA to exposures relating to 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 2014, the total credit risk exposure of the Group in respect of the liquidity facilities provided to Cancara amounted to £7.4bn (2013: £6.1bn), none of which has been drawn down (2013: nil). An analysis of this exposure, by underlying exposure type, is provided in the table below.

Table 61:
Analysis of Cancara positions by exposure type

Exposure type	2014 Exposure £m	2013 Exposure £m
Mortgage Backed Securities:		
Non US Residential Mortgage Backed Securities (RMBS)	**156**	55
Commercial Mortgage Backed Securities (CMBS)	**27**	29
Personal Sector:		
Auto loans	**3,732**	2,729
Credit cards	**288**	241
Personal loans	**519**	167
Trade receivables	**1,124**	1,115
Insurance premium funding loans	**1,053**	973
Capital calls	**330**	397
Other receivables[1]	**122**	345
Total credit risk exposure	**7,351**	6,051

[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 IAA is provided in the table below.

Table 62:
Analysis of Cancara positions by risk weight category

S&P equivalent rating and IAA Risk Weight	2014 Exposure £m	2014 Capital requirement £m	2013 Exposure £m	2013 Capital requirement £m
AAA: 7%	**3,652**	**22**	3,079	18
AA: 8%	**1,792**	**13**	1,089	8
A+: 10%	**334**	**3**	819	7
A: 12%	**1,479**	**15**	973	10
A-: 20%	**65**	**4**	62	1
BBB: 60%	**29**	**1**	29	1
Total credit risk exposure/capital requirement	**7,351**	**58**	6,051	45

Direct investments and liquidity facilities

In addition to sponsoring ABCP 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 298 to 301 of the 2014 Lloyds Banking Group plc Annual Report and Accounts.

As at 31 December 2014, the total credit risk exposure arising in respect of the risk positions attached to direct investments in third party asset backed securities and the provision of liquidity facilities to third party securitisations amounted to £5.0bn (2013: £7.2bn).

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

Table 63:
Analysis of invested positions by exposure type

Exposure type	2014 Exposure £m	2013 Exposure £m
Mortgage Backed Securities:		
US RMBS	**160**	172
Non-US RMBS	**1,428**	2,417
CMBS	**1,480**	1,937
Collateralised Debt Obligations:		
CLO	**1,300**	1,681
Other	**149**	240
Personal sector:		
Auto loans	**316**	557
Personal loans	**42**	8
FFELP student loans	**207**	308
Total	**5,082**	7,320
SCRAs taken to reserves[1]	**–**	(56)
Deduction from capital	**(56)**	(55)
Total credit risk exposure[2]	**5,026**	7,209

[1] SCRAs taken to reserves refer to 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 £2.2bn during the year, primarily reflecting disposals and the non-replenishment of holdings after amortisations and maturities.

Pillar 1 Capital requirements: Credit risk – securitisation continued

As at 31 December 2014, 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 RBA, amounted to £5.1bn (2013: £7.3bn), generating a capital requirement of £109m (2013: £216m). An analysis of these positions, by risk weight category, is provided in the table below.

Table 64:
Analysis of invested positions by risk weight category

		Securitisation Positions 2014						Re-securitisation Positions 2014		Total 2014		Total 2013	
		Senior		Non-senior		Tranches Backed by Non Granular Pools		Senior					
S&P Equivalent Rating and RBA Risk Weight[1]		Exposure £m	Cap req £m	Exposure £m	Cap req £m	Exposure £m	Cap req £m	Exposure £m	Cap req £m	Exposure £m	Cap req £m	Exposure £m	Cap req £m
On Balance Sheet													
AAA	(7%, 12%, 20%, 20%)	1,149	6	7	–	1	–	–	–	1,157	6	1,867	12
AA	(8%, 15%, 25%, 25%)	550	4	115	1	369	7	33	1	1,067	13	1,503	19
A+	(10%, 18%, 35%, 35%)	–	–	–	–	107	3	–	–	107	3	118	4
A	(12%, 20%, 35%, 40%)	17	–	18	–	17	1	–	–	52	1	96	1
A-	(20%, 35%, 35%, 60%)	210	3	–	–	50	1	–	–	260	4	366	11
BBB+	(35%, 50%, 50%, 100%)	–	–	–	–	–	–	–	–	–	–	45	2
BBB	(60%, 75%, 75%, 150%)	143	7	–	–	–	–	–	–	143	7	283	13
BBB-	(100%, 100%, 100%, 200%)	31	3	–	–	80	3	–	–	111	6	339	16
BB+	(250%, 250%, 250%, 300%)	1	–	–	–	–	–	–	–	1	–	49	10
BB	(425%, 425%, 425%, 500%)	3	1	–	–	4	1	–	–	7	2	100	36
BB-	(650%, 650%, 650%, 750%)	–	–	–	–	39	–	–	–	39	–	–	–
Below BB- or unrated	Deduction	1	–	–	–	3	–	–	–	4	–	83	–
Off Balance Sheet													
AAA	(7%, 12%, 20%, 20%)	22	–	–	–	495	9	–	–	517	9	622	10
AA	(8%, 15%, 25%, 25%)	414	3	–	–	140	3	–	–	554	6	504	5
A+	(10%, 18%, 35%, 35%)	–	–	–	–	148	4	–	–	148	4	148	4
A	(12%, 20%, 35%, 40%)	61	1	–	–	305	9	–	–	366	10	410	11
A-	(20%, 35%, 35%, 60%)	–	–	–	–	245	7	–	–	245	7	401	11
BBB+	(35%, 50%, 50%, 100%)	27	1	–	–	75	3	–	–	102	4	1	–
BBB	(60%, 75%, 75%, 150%)	44	2	–	–	14	1	–	–	58	3	215	14
BBB-	(100%, 100%, 100%, 200%)	–	–	–	–	19	2	–	–	19	2	44	4
BB+	(250%, 250%, 250%, 300%)	17	3	–	–	13	3	–	–	30	6	14	3
BB	(425%, 425%, 425%, 500%)	29	11	–	–	10	3	–	–	39	14	84	30
BB-	(650%, 650%, 650%, 750%)	–	–	–	–	4	2	–	–	4	2	–	–
Below BB- or unrated	Deduction	–	–	–	–	52	–	–	–	52	–	28	–
Total		2,719	45	140	1	2,190	62	33	1	5,082	109	7,320	216
SCRA's taken to reserves[2]										–	–	(56)	–
Deduction from capital										(56)	–	(55)	–
Total Credit Risk Exposure – Capital Requirement[3]										5,026	109	7,209	216

[1] The RBA 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. Positions rated below BB- or that are unrated are deducted from capital, net of SCRA's applied.

[2] SCRA's 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 SCRA's, where applicable.

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 Collateralised Debt Obligation (CDO) transactions.

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.

Pillar 1 Capital requirements: Credit risk – securitisation continued

TRADING BOOK SECURITISATIONS

At 31 December 2014 the Group held a small portfolio of non-correlation trading book securitisation positions amounting to £504.9m (2013: £185.8m) with an associated market risk capital requirement of £22.8m (2013: £11.3m).

Trading book securitisation strategy and roles

The Group's Asset Backed Securities Trading Book consists primarily of investments in third party securitisation positions, and to a lesser extent, in the Group's sponsored securitisations. No re-securitisation positions were held at year end through the trading book (2013: nil).

Trading is restricted to a number of specialist centres, the most important centre being the Financial Markets business in London. The main objectives of the Asset Backed Securities Trading Book are as follows;

– to create a secondary market through normal market making activity for the Group's 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 the Group's 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 amortisation or pre-payment risk. The risk stems from specific amortisation events or payout events that cause the security to be paid off in a manner significantly different from expectations.
– 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 ABS Trading Book is relatively small and with maximum holding period limits, with positions held for the short-term, liquidity risk is considered to be low.

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 Securities Trading Book is shared between Credit Risk and Market Risk teams. Under Credit Risk, positions are subject to notional limits and also maximum holding periods; notional limits are defined as a function of the ABS sub asset class and credit rating. Market Risk monitors foreign exchange, interest rate and credit spread risk daily through the VaR models.

Hedging and unfunded credit protection

The measurement and monitoring of the hedging of exposures within the trading book is performed through the VAR and position sensitivity framework. This establishes trading book risk limits, as well as a requirement to hedge against foreign exchange risk and interest rate risk (IRR).

The ABS Trading desk in the 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 IRR of securitisation positions held in the trading book and is determined in accordance with Article 337 of the CRR, being the sum of its weighted positions resulting from the application of this Article (regardless of whether they are long or short).

Position Risk Adjustments (PRAs) under the 'IRB Approach' are applied to the relevant positions in order to determine the specific IRR 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 (2013: 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.

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 65:
Analysis of trading book securitisation positions by risk weight category

		Non-correlation trading book securitisation positions							
		Senior 2014		Non-Senior 2014		Total 2014		Total 2013	
S&P Equivalent Rating and Specific Risk PRA (IRB)[1]		Exp £m	Cap req £m	Exp £m	Cap req £m	Exp £m	Cap req £m	Exp £m	Cap req £m
AAA	(0.56%, 0.96%)	179.3	1.0	5.7	0.1	185.0	1.1	107.6	0.6
AA	(0.64%, 1.20%)	80.0	0.5	11.0	0.1	91.0	0.6	34.5	0.2
A+	(0.80%, 1.44%)	–	–	10.4	0.2	10.4	0.2	–	–
A	(0.96%, 1.60%)	5.5	0.1	30.9	0.5	36.4	0.6	2.0	–
A-	(1.60%, 2.80%)	5.4	0.1	44.9	1.3	50.3	1.4	2.1	–
BBB+	(2.80%, 4.00%)	2.1	0.1	19.4	0.8	21.5	0.9	7.3	0.2
BBB	(4.80%, 6.00%)	2.4	0.1	49.2	2.9	51.6	3.0	0.7	–
BBB-	(8.00%, 8.00%)	8.2	0.7	27.6	2.2	35.8	2.9	10.8	0.9
BB+	(20.00%, 20.00%)	1.3	0.3	–	–	1.3	0.3	1.1	0.2
BB	(34.00%, 34.00%)	2.7	0.9	0.7	0.2	3.4	1.1	3.3	1.1
BB-	(52.00%, 52.00%)	–	–	15.2	7.7	15.2	7.7	14.0	7.3
Unrated	(100.00%, 100.00%)	–	–	3.0	3.0	3.0	3.0	2.4	0.8
Total		**286.9**	**3.8**	**218.0**	**19.0**	**504.9**	**22.8**	185.8	11.3

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

[2] The capital requirement amounts are based on the sum of its net long and net short positions as per CRD IV rules. In 2013, they were determined in accordance with the transitional requirements, being the higher of the capital charges applied to the net long positions or to the 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 66:
Analysis of trading book securitisation positions by exposure type

Exposure Type	2014 Exposure £m	2014 Capital requirement £m	2013 Exposure £m	2013 Capital requirement £m
RMBS	90.9	0.6	68.2	7.6
CMBS	4.1	0.3	16.9	1.6
Credit cards	38.7	0.2	7.7	–
Loans to corporates	2.1	0.1	1.1	–
Trade receivables	0.6	–	0.2	–
Leasing	83.1	0.5	44.4	0.3
Corporate bonds	236.0	16.5	–	–
Other	49.4	4.6	47.3	1.8
Total	**504.9**	**22.8**	185.8	11.3

Key movements

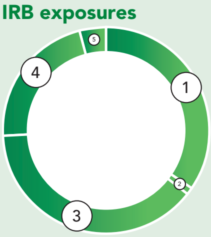
– Exposures have increased in the year primarily due to an expansion in bond exposures held and a change in the capital requirement calculation as noted above.

Pillar 1 Capital requirements: Counterparty credit risk

This section details Lloyds Banking Group's counterparty credit risk profile, focussing on regulatory measures such as exposure at default and risk-weighted assets.

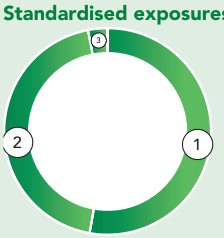
- Counterparty credit risk represents a small proportion (4%) of the Group's total risk-weighted assets
- Risk-weighted assets increased by 45% to £11.3bn primarily due to the Credit Value Adjustment (CVA) capital charge coming into effect under CRD IV.
- Counterparty credit risk exposures increased by 60% to £34.2bn mainly due to CRD IV rule changes resulting in the recognition of central counterparty exposures for risk-weighted purposes and an increase in securities financing transactions with central banks.

IRB exposures



1. Corporate – main 35%	(2013: 30%)
2. Central governments and central banks 1%	(2013: 3%)
3. Institutions 39%	(2013: 45%)
4. Corporate – specialised lending 22%	(2013: 21%)
5. Securitisation positions 3%	(2013: 1%)

Standardised exposures



1. Central governments and central banks 53%	(2013: 78%)
2. Institutions 44%	(2013: 7%)
3. Corporates 3%	(2013: 15%)

DEFINITION

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 PFE 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 PFE 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 repo 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 may be 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 2014 showed that the banking business had liquidity resources representing 148 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). Assets and liabilities within the TSB Banking Group were not included as their risk appetite is managed separately.

The liquidity 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 £2.5bn of cash over a period of up to one year, £2.4bn of collateral posting related to customer financial contracts and £8.6bn 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 51 (Financial instruments), Notes to the Consolidated Financial Statements, 2014 Lloyds Banking Group plc Annual Report and Accounts, pages 283 to 285.

Pillar 1 Capital requirements: Counterparty credit risk continued

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY MEASUREMENT APPROACH

The credit risk exposure value in respect of counterparty credit risk as at 31 December 2014 was £34.2bn (2013: £21.3bn). An analysis by measurement approach is presented in the table below.

Table 67:
CCR: analysis by measurement approach

	2014 Credit risk exposure[1] £m	2013 Credit risk exposure[1] £m
CCR standardised approach	–	–
CCR mark to market method	26,997	21,345
CCR internal model method	–	–
CCR central counterparty	7,180	–
	34,177	21,345

[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 2014, by exposure class, is presented in the table below.

Table 68:
CCR: analysis by exposure class

	2014 Credit risk exposure £m	2013 Credit risk exposure £m
Foundation IRB approach		
Central governments and central banks	226	515
Institutions	7,016	7,602
Corporate – main	6,308	5,037
Other IRB approach		
Corporate – specialised lending[1]	3,983	3,673
Securitisation positions[2]	528	185
Total	18,061	17,012
Exposures subject to the standardised approach		
Central governments and central banks	8,482	3,355
Institutions	7,182	303
Corporates	452	664
Retail	–	1
Exposures in default	–	10
	16,116	4,333
Total	34,177	21,345

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

[2] Securitisation positions include £142m (2013: £74m) of net exposure deducted from capital.

Key movements

– Counterparty credit risk exposures increased by £12.8bn over the year, mainly due to CRD IV rule changes resulting in the recognition of exposures with central counterparties for risk-weighting purposes, an increase in securities financing transactions with central banks, and mark to market movements.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY CONTRACT TYPE

An analysis of counterparty credit risk exposures as at 31 December 2014, by contract type, is presented in the table below.

Table 69:
CCR: analysis by contract type

	2014 Credit risk exposure £m	2013 Credit risk exposure £m
Interest rate and inflation contracts	**14,565**	11,733
Foreign exchange contracts	**3,794**	2,111
Equity contracts	**252**	471
Credit derivatives	**835**	313
Commodity contracts	**1,401**	17
Securities financing transactions	**13,330**	6,700
Total	**34,177**	21,345
Of which central counterparty[1]	**7,180**	–

[1] Exposures to central counterparties at 31 December 2013 carried a nil value in accordance with the rules prevailing at the time.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY RISK WEIGHT APPROACH

An analysis of counterparty credit risk exposures and RWAs as at 31 December 2014, by risk weight approach, is presented in the table below.

Table 70:
CCR: analysis by risk weight approach

	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2013 Credit risk exposure £m	2013 Risk-weighted assets £m
Foundation and other IRB approaches	**18,061**	**8,638**	17,012	7,082
Standardised approach	**8,936**	**325**	4,333	712
Central counterparty[1]	**7,180**	**145**	–	–
Total	**34,177**	**9,108**	21,345	7,794
Credit valuation adjustment	**–**	**2,215**	–	–
Total	**34,117**	**11,323**	21,345	7,794

[1] Exposures to central counterparties at 31 December 2013 carried a nil value in accordance with the rules prevailing at the time.

Key movements

– Counterparty credit risk risk-weighted assets, increased from £7.8bn to £11.3bn, reflecting a number of methodology changes, including CRD IV changes that introduced credit valuation adjustment (CVA) and the application of the FII scalar, and mark to market movements.

Pillar 1 Capital requirements: Counterparty credit risk continued

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.

Table 71:
CCR central government and central bank exposures by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	**167**	**0.02%**	**1.87%**	434	0.02%	2.37%
5	–	–	–	–	–	–
6	**56**	**0.07%**	**9.34%**	4	0.07%	14.18%
7	–	–	–	3	0.11%	13.19%
8	–	–	–	74	0.17%	19.54%
9	–	–	–	–	–	–
10	–	–	–	–	–	–
11	–	–	–	–	–	–
12	–	–	–	–	–	–
13	**2**	**1.87%**	**99.16%**			
14	–	–	–	–	–	–
15	–	–	–	–	–	–
16	–	–	–	–	–	–
17	–	–	–	–	–	–
18	–	–	–	–	–	–
19	**1**	**28.60%**	**249.81%**	–	–	–
20 – 23 (Default)	–	–	–	–	–	–
Total	**226**	**0.14%**	**5.41%**	515	0.05%	5.07%

Table 72:
CCR institution exposures by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	**2,357**	**0.03%**	**27.09%**	1,788	0.03%	13.79%
5	**823**	**0.04%**	**22.11%**	2,501	0.04%	15.64%
6	**2,782**	**0.06%**	**32.36%**	2,218	0.06%	20.29%
7	**533**	**0.11%**	**54.08%**	597	0.11%	32.51%
8	**64**	**0.18%**	**41.34%**	66	0.18%	41.70%
9	**312**	**0.28%**	**83.53%**	253	0.28%	49.03%
10	**86**	**0.42%**	**86.00%**	125	0.45%	64.46%
11	**9**	**0.75%**	**97.33%**	21	0.75%	86.83%
12	**29**	**1.00%**	**91.38%**	14	1.01%	78.53%
13	**4**	**1.62%**	**99.42%**	1	1.62%	99.32%
14	**10**	**3.07%**	**137.42%**	6	2.39%	117.42%
15	–	–	–	1	4.50%	159.15%
16	–	–	–	–	–	–
17	**7**	**8.00%**	**200.85%**	3	8.00%	196.81%
18	–	–	–	–	–	–
19	–	–	–	8	31.00%	285.34%
20 – 23 (Default)	–	–	–	–	–	–
Total	**7,016**	**0.08%**	**34.73%**	7,602	0.11%	20.80%

Key Movements

– The increase in average risk weight from 20.80% to 34.73% primarily reflects the implementation of the FII scalar as part of methodology changes through CRD IV and changes in portfolio composition.

Table 73:
CCR corporate exposures by PD grade

PD grade	2014 Credit risk exposure £m	2014 Exposure weighted average PD %	2014 Average risk weight %	2013 Credit risk exposure £m	2013 Exposure weighted average PD %	2013 Average risk weight %
1 – 4	**1,661**	**0.03%**	**20.24%**	1,065	0.03%	22.69%
5	**101**	**0.05%**	**19.56%**	164	0.05%	12.57%
6	**856**	**0.07%**	**21.11%**	540	0.07%	20.96%
7	**770**	**0.11%**	**38.69%**	563	0.11%	39.67%
8	**615**	**0.18%**	**51.73%**	435	0.17%	48.98%
9	**894**	**0.28%**	**53.71%**	677	0.27%	53.11%
10	**506**	**0.42%**	**74.26%**	579	0.42%	62.63%
11	**208**	**0.63%**	**83.56%**	222	0.68%	90.09%
12	**169**	**1.00%**	**95.18%**	182	1.07%	104.19%
13	**170**	**1.62%**	**124.24%**	111	1.70%	117.69%
14	**79**	**2.61%**	**139.83%**	87	2.70%	132.31%
15	**45**	**4.20%**	**168.03%**	6	3.87%	164.65%
16	**10**	**6.08%**	**176.15%**	33	5.58%	164.39%
17	**–**	**–**	**–**	20	8.70%	224.82%
18	**31**	**12.06%**	**231.90%**	33	13.08%	242.27%
19	**68**	**31.00%**	**282.81%**	86	30.45%	274.39%
20 – 23 (Default)	**125**	**100.00%**	**–**	234	100.00%	–
Total	**6,308**	**2.66%**	**47.91%**	5,037	5.62%	51.53%

Key Movements

– The reduction in average PD from 5.62% to 2.66% is a result of active balance sheet management in 2014 including a reduction in defaulted exposures. This has led to a reduction in the average risk weight.

Table 74:
CCR corporate exposures subject to supervisory slotting

	Remaining maturity <2.5 years		Remaining maturity >2.5 years	
Grade	2014 Exposure £m	2014 Risk-weighted assets £m	2014 Exposure £m	2014 Risk-weighted assets £m
1) Strong	**107**	**60**	**2,662**	**1,852**
2) Good	**64**	**46**	**341**	**305**
3) Satisfactory	**79**	**90**	**440**	**506**
4) Weak	**5**	**13**	**55**	**137**
5) Default[1]	**3**	**–**	**227**	**–**
Total	**258**	**209**	**3,725**	**2,800**

	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

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

Pillar 1 Capital requirements: Counterparty credit risk continued

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 2014, are presented separately in the table below.

Table 75:
Net derivatives credit exposure

	2014 £m	2013 £m
Gross positive fair value of contracts	69,655	48,726
Netting benefits	(57,359)	(38,758)
Netted current credit exposure	12,296	9,968
Net potential future credit exposure	12,260	7,042
Collateral held[1]	(3,709)	(2,365)
Total net derivatives credit exposure	20,847	14,645
of which CCP	5,359	–
Securities financing transactions	13,330	6,700
Total counterparty credit risk exposure[2]	34,177	21,345
of which CCP	7,180	–

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

[2] At 31 December 2013 total counterparty credit risk exposures related to trades not settled through central counterparties. Exposures settled through central counterparties included in the netted current credit exposure were revised down to an EAD value of nil, in accordance with regulatory requirements that applied at 31 December 2013, through an adjustment applied to the net potential future credit exposure and did 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 subanalysed by those settled by central counterparties and those not settled by central counterparties) is provided on page 124 of the 2014 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 2014 was £24.6bn (2013: £8.9bn), an analysis of which is presented in the table below. These transactions relate to CDS's and total return swaps.

Table 76:
Notional value of credit derivative transactions

	2014 Notional value £m	2013 Notional value £m
Own credit portfolio – protection bought[1]	9,581	3,476
Own credit portfolio – protection sold[2]	14,993	5,442
Total	24,574	8,918

[1] Own credit portfolio (protection bought) comprises £9,042m (2013: £3,331m) of CDS's and £539m (2013: £145m) of total return swaps.

[2] Own credit portfolio (protection sold) comprises £8,439m (2013: £2,654m) of CDS's and £6,554m (2013: £2,788m) of total return swaps.

Pillar 1 Capital requirements: Market risk

This section details Lloyds Banking Group's market risk profile, focussing in particular on the Group's internally modelled market risk measures.

- Market risk represents a small amount (2%) of the Group's total risk-weighted assets.
- Risk weighted assets reduced by 57% to £4.7bn mainly due to the removal of a temporary capital buffer applied to the Group's internal market risk models on completion of specific market risk infrastructure projects.
- Backtesting of VaR models over 2014 demonstrated that the models performed as expected.
- Market value sensitivity and net interest income sensitivity measures provided in respect of banking activities (non-trading book) (Tables 83 and 84).
- Board Risk Appetite for market risk is set at group level covering market risk across all divisions and is reviewed and approved annually.

Pillar 1 Capital requirements: Market risk continued

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 reductions in earnings and/or value.

RISK APPETITE

The Group's Risk Management Framework articulates accountabilities for the management of market risk across the Group, and how this is discharged through a robust governance structure against sanctioned risk appetite. Market risk exposures are measured and controlled through a combination of scenario/stress analysis, percentile based measures and sensitivity analysis.

EXPOSURES

Market risk balance sheet linkages

The information provided in Table 77 aims to facilitate the understanding of linkages between balance sheet items and the positions disclosed in the Group's market risk disclosures. This breakdown of financial instruments included and not included in trading book VaR provides a linkage with the market risk measures reported later on in the market risk section. It is important to highlight that this table does not reflect how the Group manages market risk, since it does not discriminate between assets and liabilities in its VaR model.

Table 77:
Market risk linkage to the balance sheet

		Banking			
31 December 2014	Balance sheet total £m	Trading book only £m	Non-trading £m	Insurance £m	Primary risk factor
Assets					
Cash and balances at central banks	50,492	–	50,492	–	Interest rate
Items in the course of collection from banks	1,173	–	1,173	–	Interest rate
Trading and other financial assets at fair value through profit or loss	151,931	48,494	9,123	94,314	Interest rate, foreign exchange, credit spread
Derivative financial instruments	36,128	30,209	4,233	1,686	Interest rate, foreign exchange, credit spread
Loans and receivables:					
Loans and advances to banks	26,155	–	4,843	21,312	Interest rate
Loans and advances to customers	482,704	–	482,704	–	Interest rate
Debt securities	1,213	–	1,213	–	Interest rate, credit spread
Available-for-sale financial assets	56,493	–	56,491	2	Interest rate, credit spread, foreign exchange
Value of in-force business	4,864	–	–	4,864	Equity
Other assets	43,743	–	19,808	23,935	Interest rate
Total assets	854,896	78,703	630,080	146,113	
Liabilities					
Deposits from banks	10,887	–	10,887	–	Interest rate
Customer deposits	447,067	–	447,067	–	Interest rate
Items in course of transmission to banks	979	–	979	–	Interest rate
Trading and other financial liabilities at fair value through profit or loss	62,102	55,359	6,743	–	Interest rate, foreign exchange
Derivative financial instruments	33,187	27,811	3,616	1,760	Interest rate, foreign exchange, credit spread
Debt securities in issue	76,233	–	76,233	–	Interest rate
Liabilities arising from insurance and investment contracts	114,166	–	–	114,166	Credit spread
Subordinated liabilities	26,042	–	23,485	2,557	Interest rate, foreign exchange
Other liabilities	34,330	–	8,575	25,755	Interest rate
Total liabilities	804,993	83,170	577,585	144,238	

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

As Insurance undertakings are excluded from the scope of the Group's regulatory consolidation, market risks in respect of the assets and liabilities relating to the Group's insurance operations are covered in more detail in the Market Risk section of the 2014 Lloyds Banking Group plc Annual Report and Accounts (pages 138 to 143).

The Group's trading book assets and liabilities are 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. The assets and liabilities are classified as trading books if they have been acquired or incurred for the purpose of selling or repurchasing in the near future. These consist of government, corporate and financial institution bonds and loans/deposits and repos.

Derivative assets and liabilities are held for three main purposes; to provide risk management solutions for clients, to manage portfolio risks arising from client business and to manage and hedge the Group's own risks. The majority of derivatives exposure arises within Financial Markets.

The Group ensures that it has adequate cash and balances at central banks and stocks of high-quality liquid assets (eg Gilts or US Treasury Securities) that can be converted easily into cash to meet liquidity requirements. The majority of these assets are held as Available-for-Sale with the remainder held as financial assets at fair value through profit and loss. IRR in the asset portfolios is swapped into floating.

The majority of debt issuance originates from the Issuance, Capital Vehicles and Medium Term Notes desks and the IRR of the debt issued is hedged by swapping them into a floating rate.

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 Division. The average 95 per cent 1-day trading VaR was £4.3m for the year to 31 December 2014 (2013: £4.1m). The Group's trading activity is undertaken to meet the requirements of commercial 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 80), sensitivity based measures and stress testing.

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.

IRR 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 table 77) and off balance sheet positions of the Group. IRR arises predominantly from the mismatch between interest rate sensitive assets and liabilities, but also to the reinvestment rate on the Group's structural hedging of rate insensitive liabilities comprising customer deposits and net free 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 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:

– translational exposure: the Group's investment in its overseas operations. Net investment exposures are disclosed (see note 54 on page 293 of the Annual Report and Accounts) and it is Group policy to hedge non-functional currency exposures; and
– 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.

Equity Risk arises from different sources:

– the Group's equity holdings in Banco Sabadell and Aberdeen Asset Management;
– exposure to Lloyds Banking Group share price through deferred shares and deferred options granted to employees as part of their benefits package; and
– the Group's private equity investments.

Credit spread risk arises largely from the following:

– the assets held mainly within the liquid asset portfolio; and
– the CVA and DVA sensitivity to credit spreads. 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.

Pillar 1 Capital requirements: Market risk continued

Table 78:
Key market risks for the Group by individual business activity (profit before tax impact measured against Group single stress scenarios)

	Risk type					
	Interest rate	Basis risk	FX	Credit spread	Equity	Inflation
Defined benefit pension schemes	£50m to <£250m		<£50m	£250m to £500m	£50m to <£250m	<£50m
Trading portfolios	<£50m		<£50m	<£50m		<£50m
Banking activities	£50m to <£250m	£50m to <£250m	<£50m	£250m to £500m	£250m to £500m	<£50m
Insurance portfolios	£50m to <£250m		<£50m	>£500m	>£500m	£50m to <£250m

Key:
Profit before tax:
>£500m ● £250m to £500m ● £50m to <£250m ● <£50m ●

For further information on the key market risks by defined benefit pension schemes and Insurance portfolios refer to pages 139 to 140 of the Annual Report and Accounts.

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.

In addition:

– 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.

Review of internal models

The Group's internal market risk model permission allows it to calculate Pillar 1 market risk capital requirements for the trading book using internal models. The Lloyds Banking Group 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 IRR and the capital charge incorporates specific IRR 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.

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 includes 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.

Any material risk factors that fall within the scope of the trading books using internal models and are insufficiently captured by the VaR model are identified and measured as a Risk not in VaR (RNIV). For example where there is limited historical market data or limited variability in the market data. Identification of risks is performed at least quarterly to ensure any additional risks are captured as RNIV's.

Validation of the risk models uses a number of methods including but not limited to stress tests, sensitivity analyses and scenarios analyses. The risk models, including the RNIVs, are 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	Number of days of market data	Applicable regulatory thresholds for the industry
VaR	1Model; (£23m)	Historical simulation to create a distribution of potential daily P&Ls from market moves	300 daily P&Ls	Regulatory VaR is computed with 10 day holding period and 99% confidence level
SVaR	1Model: (£121m)	Same as VaR model	250 day period of significant stress, updated quarterly	Regulatory SVaR is computed with 10 day holding period and 99% confidence level
IRC	1Model: (£55m)	Monte Carlo approach is used to simulate the profit and loss changes arising from rating migration and default	Credit Ratings data (1981 – current), CDS bond basis data (2007- current), LGD data (1991-current)	IRC is computed with a 1 year holding period and 99.9% confidence level

Stress testing

The Group has a comprehensive trading book stress testing programme. Economic scenarios representing extreme but plausible stressed market events are applied to the trading book. These scenarios stress numerous risk factors including interest rates, interest rate spreads, interest rate volatilities, inflation swap rates, inflation volatilities, FX rates, FX volatilities and credit spreads.

There are two sets of stress-testing applied to the trading book: macro-economic and asset class specific. The macro-economic scenarios apply a set of historical events such as the Lehmans default, possible economic events such as what might happen if the Euro breaks up and also regulator provided scenarios such as the EBA stress tests. The macro-economic scenarios are intended to be severe but holistic and plausible. The asset class specific scenarios, also known as desk specific, are intended to apply extreme events to individual risk factors with stresses being applied in groups and to identify points of weakness at both asset class and trading book level.

The market risk function produce stress testing daily and these are reviewed by Financial Markets businesses weekly to facilitate the management of the market risk within their businesses. Limits and triggers apply to stress testing as part of the market risk limit framework. If any of the daily reports show stress testing concerns these are raised with the business immediately.

The stress testing programme is reviewed quarterly and new stress tests are introduced when deemed necessary.

Backtesting of VaR models

The Group compares hypothetical profit or 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 business unit level. Hypothetical profit or loss is the change in the valuation of the portfolio 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 2014.

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 Internal Model Approval Market Risk 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 112 to 114.

Pillar 1 Capital requirements: Market risk continued

Table 79:
Backtesting results (VaR models)

2014 backtesting results	Zone[1]	Number of reported exceptions
Entity level		
Lloyds Bank	Green	0
HBOS	Green	2
LBG	Green	0
Major business area		
Rates product	Green	0
FX product	Green	0
Credit product	Green	0
Repo product	Green	0

[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 2014 has considered that no action is required to rectify or adapt its VaR models.
- The HBOS backtesting exceptions in 2014 occurred on 1 and 12 December 2014. The loss on 1 December was due to a significant upward move in EUR interest rates during the day. The loss on 12th December was due to a significant downward move in GBP interest rates during the day.

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 51 (Financial instruments), Notes to the Consolidated Financial Statements, of the 2014 Lloyds Banking Group plc Annual Report and Accounts.

The main valuation adjustments are summarised below:

- 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.
- The Group applies a Funding Valuation Adjustment to adjust for the net cost of funding certain uncollateralised derivative positions where the Group considers that this cost is included in market pricing. This adjustment is calculated on the expected future exposure discounted at a suitable cost of funds.
- 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 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 availability of independent data, monthly being the minimum. Valuation differences in breach of established thresholds are escalated to senior management. The results from independent pricing and valuation reserves are reviewed monthly by senior management.

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 2014 and 2013 based on the Group's global trading positions is detailed in the table below.

The risk of loss measured by the VaR model is the minimum expected loss in earnings given the confidence level and assumptions noted above. The total and average trading VaR reported below does not assume any diversification benefit across the five risk types. The Group internally uses VaR as the primary measure for all trading book positions arising from short term market facing activity. 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 average VaR for 2014 was similar to the average over 2013.

Table 80:
Trading portfolios: VaR (1-day 95 per cent confidence level)

VaR measures	2014 Close £m	2014 Average £m	2014 Maximum £m	2014 Minimum £m
At 31 December 2014				
Interest rate risk	1.7	2.8	4.8	1.3
Foreign exchange risk	0.2	0.4	1.3	0.0
Equity risk	–	–	–	–
Credit spread risk	0.6	0.7	1.1	0.5
Inflation risk	0.4	0.3	0.8	0.2
Total VaR	2.8	4.3	6.4	2.5

VaR measures	2013 Close £m	2013 Average £m	2013 Maximum £m	2013 Minimum £m
At 31 December 2013				
Interest rate risk	3.5	2.9	4.8	2
Foreign exchange risk	0.2	0.4	2	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

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.

Trading risk appetite is controlled with VaR limits. Limits are allocated on a 95 per cent 1 day VaR. VaR limits are complemented with profit and loss referrals, positional limits, and stress test triggers. VaR limits are set and managed at both desk and overall trading book levels.

Although an important market standard measure of risk, VaR has limitations. These arise from the use of limited historical data which may not encompass all potential events, particularly those which describe extreme market conditions, defined holding periods which assume the risk can be liquidated or hedged within that period and the exposure level at the confidence interval does not convey any information about potential losses which may occur if this level is exceeded. The Group recognises these limitations and supplements the use of VaR with a variety of other measurements which reflect the nature of the business activity. These include detailed sensitivity analysis, position reporting and stress testing analysis.

The Group holds securities within its trading books mainly under the Credit Trading, Gilts and Repo Trading businesses within Financial Markets for funding and to meet customer requirements. The outright IRR exposure, after hedging, is small relative to the Group.

The Group's Stressed VaR (based on a 10-day 99 per cent confidence level) and IRC measures presented on a similar basis to the VaR measures above are detailed in the table overleaf.

Pillar 1 Capital requirements: Market risk continued

Table 81:
Trading portfolios: Stressed VaR (10-day 99 per cent confidence level) and incremental risk charge

Stressed VaR/IRC measures	2014 Close £m	2014 Average £m	2014 Maximum £m	2014 Minimum £m
Interest rate risk	45.1	40.5	78.7	14.2
Foreign exchange risk	40.5	17.6	44.4	1.0
Credit spread risk	10.2	17.7	26.8	10.2
Total Stressed VaR	95.9	75.9	124.6	33.2
Incremental risk charge	54.9	69.9	139.6	41.8

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

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.

Average Stressed VaR increased over 2014 compared to 2013, partly due to increased exposure to foreign exchange Stressed VaR through foreign exchange option exposures at various times of the year. It was also due to an increase in credit spread exposure over much of 2014 although a more defensive profile was taken towards the end of the year.

The incremental risk charge reduced over the year primarily due to a reduction in exposure to bank debt.

Market risk capital requirement

As at 31 December 2014 the capital requirement in respect of market risk in the trading book amounted to £380m (2013: £887m).

Table 82:
Analysis of market risk capital requirement

Approach/risk	2014 Capital requirement £m	2013 Capital requirement £m
Internal models approach		
VaR	23	56
Stressed VaR	121	240
RNIV	50	21
Incremental risk charge	55	106
Standardised approach		
Interest rate position risk requirement	125	136
of which: specific interest rate risk of securitisation positions[1]	23	11
Foreign currency position risk requirement	6	27
Equity position risk requirement	–	1
Commodity position risk requirement	–	–
	380	587
Temporary capital buffer[2]	–	300
Total	380	887

[1] Further details on the calculation of the specific interest rate risk of securitisation positions is provided on page 95 under the trading book securitisations section of the document.
[2] The temporary capital buffer was removed in April 2014, following completion of specific market risk infrastructure projects.

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 requirements reduced during 2014, primarily as a result of the removal of the temporary capital buffer, changes in the calculation of the internal model market risk capital requirements following changes to the Group's Internal Model Approval Permission in 2014 and a reduction in capital required from internal models VaR, Stressed VaR and IRC as a result of reduction in interest rate and credit spread exposures within the trading books. Capital from RNIVs increased over 2014 through a combination of changes in methodologies and new RNIVs.

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.

IRR 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) 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 repricing profiles 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 and 100 basis points change to all interest rates.

Table 83:
Banking activities: market value sensitivity

	2014 Up 25bps £m	2014 Down 25bps £m	2014 Up 100bps £m	2014 Down 100bps £m	2013 Up 25bps £m	2013 Down 25bps £m	2013 Up 100bps £m	2013 Down 100bps £m
Sterling	(15.7)	15.5	(63.8)	3.9	(25.1)	25.6	(97.2)	63.0
US dollar	4.7	(4.9)	17.8	(15.9)	16.3	(16.5)	64.9	(38.9)
Euro	(7.2)	4.8	(27.3)	15.0	(0.4)	0.6	(0.6)	9.6
Australian dollar	(0.4)	0.4	(1.3)	1.8	(0.7)	(0.1)	(2.6)	(0.8)
Other	(0.3)	0.3	(1.2)	0.8	(0.3)	0.3	(1.1)	1.1
Total	(18.9)	16.1	(75.8)	5.6	(10.2)	9.9	(36.6)	34.0

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 parallel up and down 25 and 100 basis points change to all interest rates.

Table 84:
Banking activities: net interest income sensitivity

	2014 Up 25bps £m	2014 Down 25bps £m	2014 Up 100bps £m	2014 Down 100bps £m	2013 Up 25bps £m	2013 Down 25bps £m	2013 Up 100bps £m	2013 Down 100bps £m
Client facing activity and associated hedges	(4.6)	(46.0)	176.3	(222.3)	48.2	(136.0)	390.3	(364.4)

Income sensitivity is measured over a rolling 12 month basis.

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.

Low interest income sensitivity continues to reflect structural hedging against margin compression with small year on year variances reflecting changes in operational flows.

The Group ensures that it has adequate stock of high-quality liquid assets (for example Gilts or US Treasury Securities) that can be converted easily into cash to meet liquidity requirements. The IRR in these portfolios is hedged with interest rate swaps on an asset swap basis.

Pillar 1 Capital requirements: Market risk continued

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 IRR exposures within the risk appetite defined by the Board. For individual banking divisions, simple positional IRR 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 IRR in the banking book Policy, all hedgeable IRR in the non-traded book should be transferred to GCT via the IRR Transfer Pricing (ITP) framework. GCT is responsible for managing centralised risk and does this through natural offsets of matching assets and liabilities, and appropriate hedging activity of the residual exposures, subject to the authorisation and mandate of Group Asset and Liability Committee (GALCO) within the Board Risk Appetite. The Group centrally manages the overall interest rate structure of the balance sheet giving consideration to both the stability of net interest income and protection of shareholder value from changes in market interest rates. A structural hedging programme is in place to manage rate insensitive balances through investing in longer term fixed rate assets or interest rate swaps, subject to the authorisation and mandate of GALCO within the Board Risk Appetite. Derivative desks in Financial Markets will then externalise the hedges to the market. However, certain residual IRR may remain outside the centre due to differences in basis and profile mismatches, largely arising from customer behaviour. Whilst the bank faces margin decompression in the current low rate environment, its exposure to pipeline and prepayment risk are not considered material, and are appropriately monitored and controlled through Divisional Asset and Liability Committees (ALCOs).

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 GALCO 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

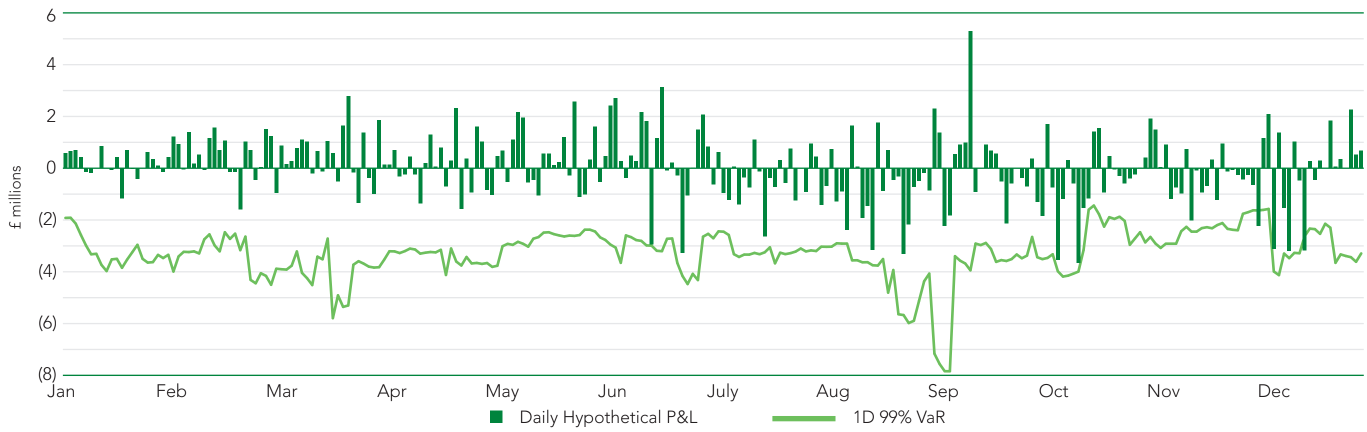
Trading is restricted to a number of specialist centres, the most important centre being the Financial Markets business in London. These centres also manage market risk in the Commercial Banking non-trading portfolios, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the 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 IRR in the banking book, which is reviewed and approved annually.

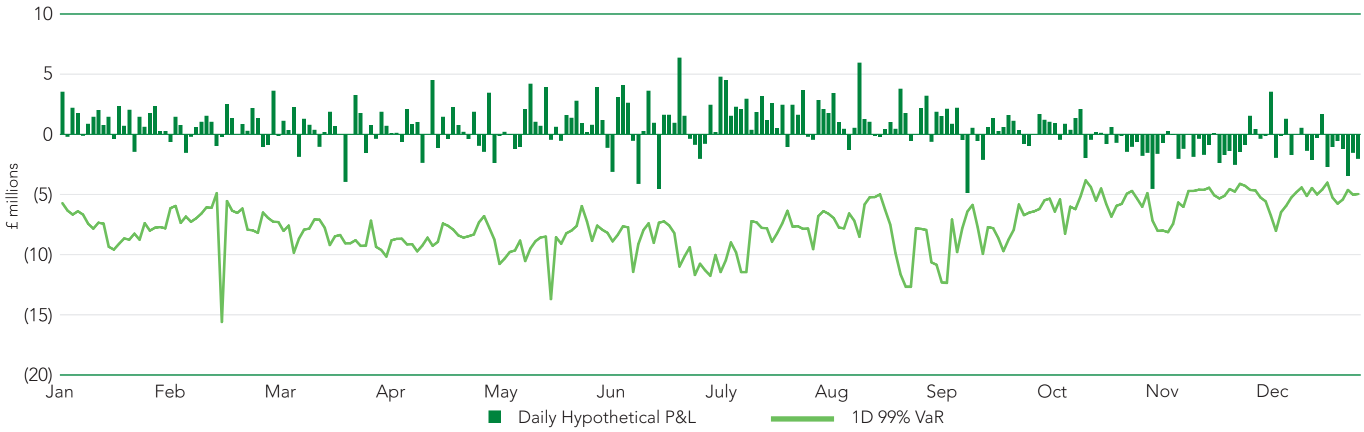
Comparison of VaR to hypothetical profit and loss

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 2014. Backtesting exceptions that arose during period have been identified, with further description provided on page 107-108.

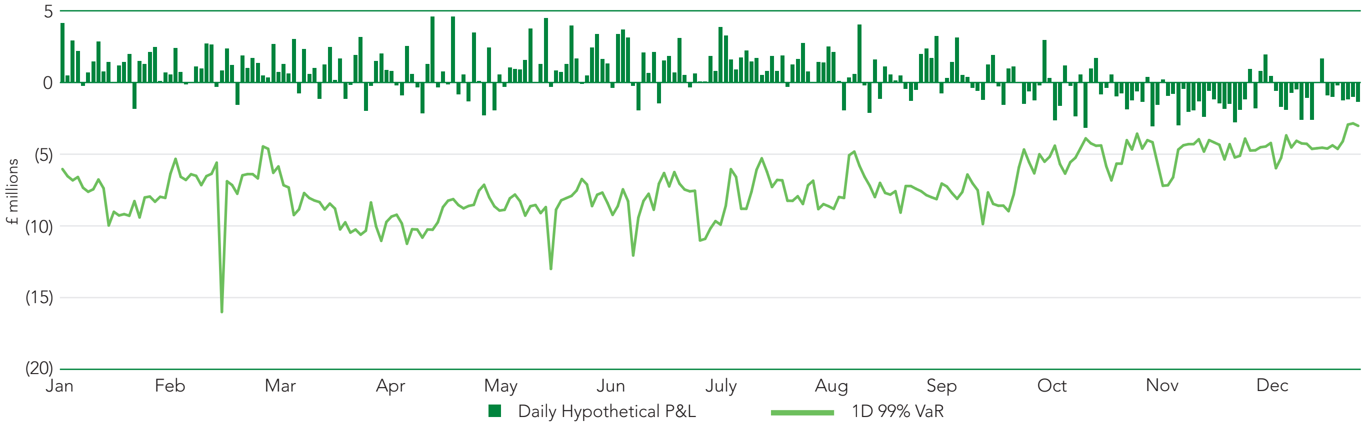
HBOS



LLOYDS BANK

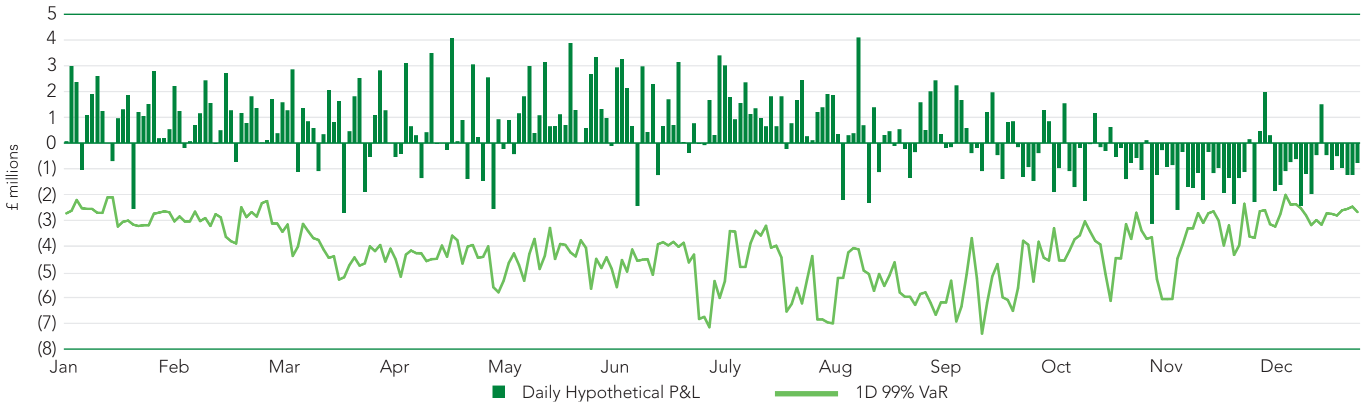


LLOYDS BANKING GROUP



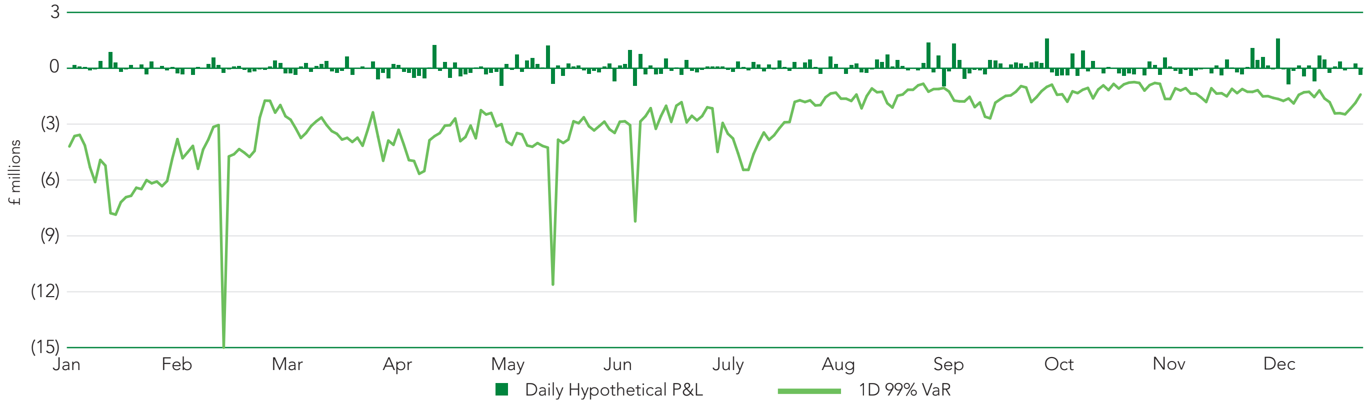
The following charts provide, by major business area, a comparison of VaR (1-day 99 per cent confidence level) to the hypothetical profit and loss on a daily basis over the course of 2014. Backtesting exceptions that arose during period have been identified, with further analysis provided on page 107-108.

RATES PRODUCT

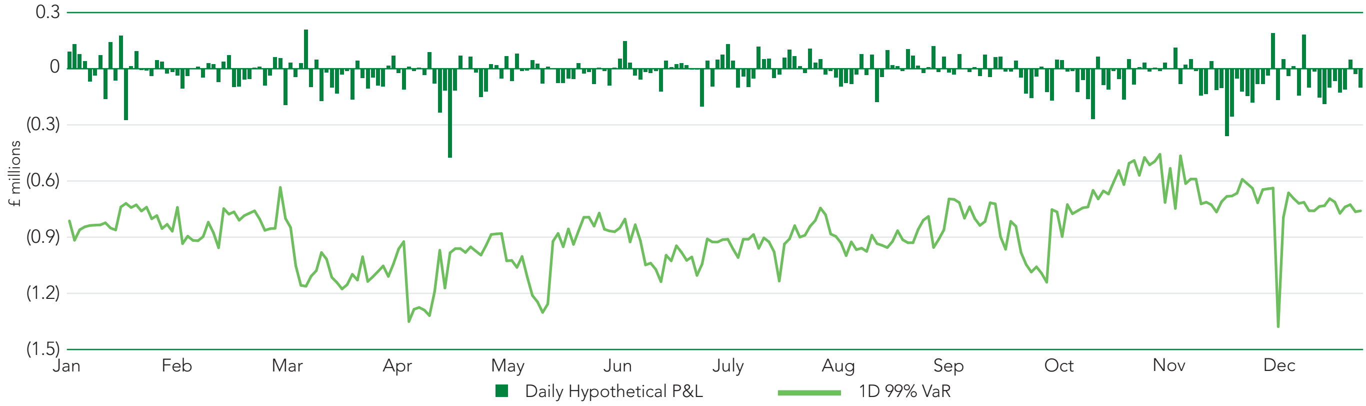


Pillar 1 Capital requirements: Market risk continued

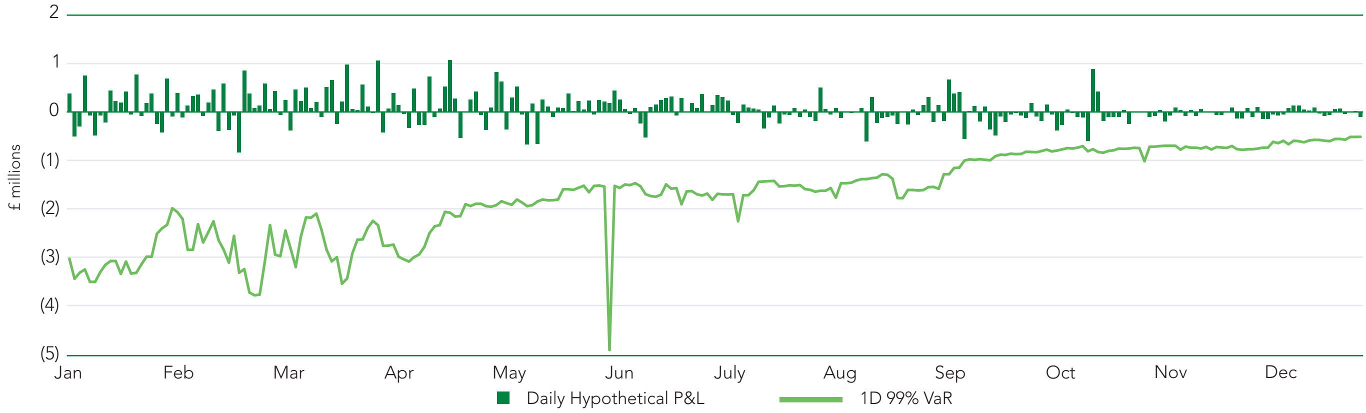
FX PRODUCT



CREDIT PRODUCT



REPO PRODUCT



Pillar 1 Capital requirements: Operational risk

This section details Lloyds Banking Group's operational risk profile, with capital requirements determined under the Standardised Approach

Pillar 1 Capital requirements: Operational risk continued

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 six 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 sentiment.
- Financial loss: The Group does not expect to experience cumulative fraud or operational losses above a defined level of budgeted Group income, or individual losses above a defined amount.
- Management time and resources: The Group does not expect internal events that divert excessive senior management time from running the business or have extensive impact on colleague time and/or morale.
- Cyber: The Group minimises the impact from cyber attacks and information breaches that result in a significant loss of customer confidence or undermine the financial stability of the Group.
- Risk culture: All colleagues are responsible for risk within their individual roles. The Group sets a strong tone from the top and 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:

- The risk that the Group is unable to provide services to customers as a result of an IT systems failure;
- Cyber risks associated with malicious attacks on the confidentiality or integrity of electronic data, or the availability of systems;
- External fraud arising from an act of deception or omission;
- Risks arising from inadequate delivery of services to customers;
- The risk associated with the ongoing provision of services to TSB and other organisations.

The risks below also have potential to negatively impact customers and the Group's future results:

- 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 are implemented and maintained by the Group to comply with increasingly complex and detailed anti-money laundering and anti-terrorism laws and regulations. However, these may not always be fully effective in preventing third parties from using the Group as a conduit for money laundering and other illegal or prohibited activities. Should the Group be associated with money laundering or breaches of financial crime regulations and prohibitions, 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 upon 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 2014, the highest frequency of events occurred in external fraud (63.17 per cent) and execution, delivery and process management (20.70 per cent). Clients, products and business practices accounted for 75.86 per cent of losses by volume driven by legacy issues where impacts materialised in 2014 (excluding Payment Protection Insurance).

The table below shows high level loss and event trends for the Group using Basel II categories.

Table 85:
Operational risk events by risk category (losses greater than or equal to £10,000)

	% of total volume		% of total losses	
	2014	2013	**2014**	2013
Business disruption and system failures	**1.38%**	0.92%	**0.26%**	0.86%
Clients, products and business practices	**14.05%**	11.02%	**75.86%**	39.66%
Damage to physical assets	**–**	0.81%	**–**	0.45%
Employee practices and workplace safety	**0.29%**	0.61%	**0.02%**	0.36%
Execution, delivery and process management	**20.70%**	24.58%	**16.71%**	38.64%
External fraud	**63.17%**	61.96%	**7.09%**	20.01%
Internal fraud	**0.41%**	0.10%	**0.06%**	0.02%
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).

In October 2014 the Basel Committee published a consultative document on revision to the simpler approaches for operational risk. The proposal is to replace the simpler approaches (which includes TSA) for calculating Pillar 1 operational risk capital with a revised Standardised Approach (SA). Calculation of the revised SA will be different to the current TSA calculation and adopting the new SA is expected to have an impact on the Group's Pillar 1 operational risk RWAs. Timelines for these changes are currently unclear. However, once the consultation ends in January 2015, the Basel Committee intends to publish the final standard within an appropriate timeframe and provide sufficient time for implementation.

MITIGATION

The Group has a strong control environment that is subject to ongoing enhancements through regular reviews and investment. Risks are reported and discussed at local governance forums and escalated to executive management as appropriate. This ensures the correct level of visibility and engagement. The Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (which would also include insurance) and acceptance. Contingency plans are maintained for a range of potential scenarios, with regular disaster recovery and scenario testing scheduled to test and challenge the readiness of the Group to respond in the event of an incident.

- An independent review of the Group's IT Resilience and supporting capabilities was completed in 2013. This highlighted areas of strength alongside known risks that have the potential to impact resilience, and a three year investment programme of strategic enhancements was initiated. The first year of this programme has been completed. Additionally the Group has developed a customer focused risk appetite for IT systems that support the Group's Critical Customer and Business Processes and continues to monitor these on a regular basis.
- The threat landscape associated with Cyber risk has continued to evolve alongside an increasing industry and Regulator focus. The Board is developing a revised Cyber Risk Appetite and is supporting incremental investment to help mitigate this risk.
- In addition to initiatives that protect the Group against a malicious Cyber attack the Group continues to invest in enhanced protection of customer information, including limiting access to key systems and enhancing the security, durability and accessibility of critical information.
- 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 remains a key component of its fraud control environment.
- The Group remediates issues that are identified in its Customer Processes, addressing root cause and rectifying customers as required. Enhancing the overall servicing environment remains a focus of dedicated Group programmes such as Simplification.
- Following the successful divestment of TSB the Group retains responsibility for the ongoing provision of key services which are 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, cyber 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, bribery and activities prohibited by legal and regulatory sanctions. The Group regularly reviews and assesses these policies to keep them current, effective and consistent across markets. The Group requires mandatory training on these topics for all employees. Specifically, the Anti-money-laundering procedures include 'know-your-customer' requirements, transaction monitoring technologies and reporting of suspicions of money laundering to the applicable regulatory authorities and the Anti-Bribery Policy prohibits the payment, offer, acceptance or request of a bribe, including "facilitation payments" by any employee or agent and provides a confidential reporting service for anonymous reporting for suspected or actual bribery activity. The Sanctions and the Related Prohibitions Policy sets out a framework of controls for compliance with legal and regulatory sanctions.

Pillar 1 Capital requirements: Operational risk continued

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, where possible 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 2014, the capital requirement in respect of operational risk amounted to £2,102m (2013: £2,128m), as determined under The Standardised Approach.

Remuneration disclosures

This section provides an analysis of remuneration awards made by the Group to its Code Staff, together with an explanation of the Group's remuneration policies, structure and governance.

Remuneration disclosures continued

REMUNERATION DISCLOSURES

This section discloses the remuneration awards made by the Group (excluding TSB) to 213 Code Staff (2013: 140) in respect of the 2014 performance year. As a consequence of the changes made by the EBA to the criteria by which Material Risk Takers are identified, the number of Code Staff within Lloyds Banking Group has increased by 52 per cent. Additional information summarising the Group's decision-making policies for remuneration is also provided. These disclosures deliver the requirements of CRR Article 450, to the extent applicable to the 2014 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 2014 there were 213 Code Staff (2013: 140) identified across the Group.

Aggregate remuneration expenditure (Code Staff)

Table 86:

Analysis of aggregate remuneration expenditure by division

	Dec-14 Retail £m	Dec-14 Commercial Banking £m	Dec-14 Consumer Finance £m	Dec-14 Insurance £m	Dec-14 Group Operations £m	Dec-14 Group Functions £m	Dec-14 Digital & Marketing[1] £m	Dec-14 Total £m
Aggregate remuneration expenditure	**7.7**	**46.7**	**5.7**	**1.4**	**9.2**	**58.3**	**3.8**	**132.8**

	Dec-13 Retail £m	Dec-13 Commercial Banking £m	Dec-13 Consumer Finance £m	Dec-13 Insurance £m	Dec-13 Group Operations £m	Dec-13 Group Functions £m	Dec-13 Digital & Marketing[1] £m	Dec-13 Total £m
Aggregate remuneration expenditure	8.6	16.4	6.9	0.9	5.5	42.2	–	80.5

[1] Digital & Marketing division was formed at the start of 2014, with individuals transferred from Retail and Consumer Finance.

Analysis of Remuneration between Fixed and Variable Amounts

Table 87:

Analysis of remuneration between fixed and variable amounts

	Dec-14 Total	Dec-14 Management Body[1]	Dec-14 Senior Managers[2]	Dec-14 Others
Number of code staff	**213**	**15**	**76**	**122**
	£m	£m	£m	£m
Fixed:				
Cash based	**55.6**	**2.5**	**25.6**	**27.5**
Share based	**11.0**	**1.9**	**6.3**	**2.8**
Total fixed pay	**66.6**	**4.4**	**31.9**	**30.3**
Variable:				
Cash	**0.3**	–	**0.1**	**0.2**
Retained shares[3]	**21.1**	–	**8.6**	**12.5**
Deferred shares	**19.3**	**1.8**	**9.3**	**8.2**
Total variable pay	**40.7**	**1.8**	**18.0**	**20.9**
LTIP[4]	**25.5**	**3.8**	**15.6**	**6.1**

[1] Management Body is defined as the three Group Executive Directors and the Group Non Executive Directors.

[2] Senior Managers are defined as Group Executive Committee (GEC) members/attendees (excluding Group Executive Directors and Non Executive Directors) and their direct reports (excluding those direct reports who do not materially influence the risk profile of any in-scope group firm).

[3] Shares subject to retention period.

[4] Based on fair value at grant.

	Dec-13 Total	Dec-13 Management Body[1]	Dec-13 Senior Managers[2]	Dec-13 Others
Number of code staff	140	14	88	38
	£m	£m	£m	£m
Fixed:				
Cash based	33.1	2.4	21.4	9.3
Total fixed pay	33.1	2.4	21.4	9.3
Variable:				
Cash	0.2	–	0.2	–
Retained shares[3]	13.4	–	10.2	3.2
Deferred shares	15.9	3.5	10.3	2.1
Total variable pay	29.5	3.5	20.7	5.3
LTIP[4]	17.9	2.2	13.8	1.9

[1] Management Body is defined as the three Group Executive Directors and the Group Non Executive Directors.

[2] Senior Managers are defined as Group Executive Committee (GEC) members/attendees (excluding Group Executive Directors and Non Executive Directors) and their direct reports (excluding those direct reports who do not materially influence the risk profile of any in-scope group firm).

[3] Shares subject to retention period.

[4] Based on fair value at grant.

Analysis of deferred remuneration

Table 88:
Analysis of deferred remuneration

	2014 code staff £m
Deferred remuneration at 31 December 2014	
Outstanding, vested	–
Outstanding, unvested	228.2
Awarded during the financial year	91.5
Paid out	68.0
Reduced through performance adjustment[1]	1.9

[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 2015.

	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

[1] This figure does not include the adjusted value of awards which were forfeited by colleagues upon leaving the Group.

Remuneration disclosures continued

Analysis of sign-on and severance payments

Table 89:
Analysis of sign-on and severance payments

	Dec-14 code staff
Severance payments	
Made during the year	–
Number of beneficiaries	–
Highest such award to a single person	–

	Dec-13 code staff
Severance payments	
Made during the year	£0.07m
Number of beneficiaries	5
Highest such award to a single person	£0.03m

There were no sign-on awards made to Code Staff during 2014 (2013: nil).

Analysis of high earners by band

Table 90:
Analysis of high earners by band

Number of code staff paid €1 million[1,2] or more	Dec-14 code staff[3]	Dec-13 code staff
€1.0m – €1.5m	27	12
€1.5m – €2.0m	9	5
€2.0m – €2.5m	–	4
€2.5m – €3.0m	7	3
€3.0m – €3.5m	1	–
€3.5m – €4.0m	4	2
€4.0m – €4.5m	–	–
€4.5m – €5.0m	–	1
€5.0m – €5.5m	–	–
€5.5m – €6.0m	–	–
€6.0m – €6.5m	1	–

[1] Converted to Euros using the exchange rate €1 = £0.8074

[2] Values for LTIP awards based on an expected value of 50% of maximum value.

[3] Total number of Code Staff earning more than €1m has increased from 27 in 2013 to 49 in 2014. This is due to the change in the EBA definition of Material Risk Taker, which has resulted in the number of Code Staff increasing from 140 in 2013 to 213 in 2014 and the strengthening of Sterling against the Euro.

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.

The Group's Remuneration Policy is based on principles which are applicable to all employees within the Group and in particular the principle that the reward package should support the delivery of our strategic goal to be the 'Best Bank for Customers'. It embeds a performance-driven and meritocratic culture, encourages effective risk disciplines and is in line with relevant regulations and codes of best practice. There is no significant difference between the policy for Executive Directors and that for other senior employees. If a significant difference for any individual were proposed, this would be subject to approval by the Remuneration Committee (within regulatory requirements).

The Group continues to maintain an open and transparent dialogue with shareholders. This valuable engagement is something the Group will seek to continue into 2015, given the responsibilities it has to the providers of the equity capital in setting fair and appropriate remuneration policies.

The Group continues to place great importance on ensuring that there is a clear link between remuneration and the Group's business strategy.

Composition of the Remuneration Committee

The members of the Committee during 2014 were Anthony Watson (chairman), Sir Winfried Bischoff (until 03/04/14), Lord Blackwell (from 03/04/14), Sara Weller, Carolyn Fairbairn, Anita Frew, David Roberts (until 14/05/14) and Dyfrig John (from 26/06/14).

During 2014, the Committee met 11 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 hires
– Feedback from the Committee Chairman on his meetings with the PRA and shareholders.
– Oversight and approval of revised bonus and performance adjustment methodology and process.
– Consideration of remuneration governance in light of regulatory changes.

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 2014 and judged its advice as objective and independent. In particular, it was recognised that Deloitte had the requisite knowledge and provides relevant external updates which enable the committee to fulfil its responsibilities. Deloitte is not connected with the Group.

António Horta-Osório (Group Chief Executive), Rupert McNeil (Group HR Director), Paul Hucknall (HR Director, Performance & Reward) and Chris Evans (Director, Performance and Reward Governance) provided guidance to the Committee (other than for their own remuneration). Juan Colombás (Chief Risk Officer) and George Culmer (Chief Financial Officer) also attended the Committee to advise as and when necessary on risk and financial matters.

Role of the relevant stakeholders

During 2014, 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 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

Remuneration disclosures continued

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 Investment Association's guidelines 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 variable remuneration awards for Executive Directors are 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.

Fixed share award

European regulatory changes, effective from 1 January 2014, introduced a cap on the variable element of remuneration at 100 per cent of fixed remuneration which may be increased to 200 per cent with shareholder approval. The Group received shareholder approval, at the Annual General Meeting on 15 May 2014, to allow variable remuneration up to a maximum of 200 per cent of fixed remuneration. 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 remuneration costs are properly managed.

During 2014 the Group introduced an additional fixed element into the reward package. This took the form of a fixed share award, made annually, which will deliver Lloyds Banking Group shares over a period of five years. This ensures that total fixed remuneration is commensurate with role and maintains 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, together with divisional achievement and individual performance. Stretching objectives relevant to improving overall business performance and aligned with the Group's strategy are contained in Balanced Scorecards and are grouped under the following headings:

- Financial
- Building the Business
- Customer Service
- Risk
- People Development

The Remuneration Committee reviewed performance in depth to determine ratings for the Group and each division, including consideration of risk matters arising in 2014. The overall rating for the Group was 'Strong'. Collective performance adjustment consideration was given to items not factored into the Group Underlying Profit or divisional balanced scorecards. These included the provisions for legacy conduct-related matters and regulatory settlements on Libor and Repo rate setting. It also considered positive factors, such as non-core disposals, the SWIP sale, the TSB separation/IPO and the reduction in government shareholding.

As a result of these items, the Remuneration Committee applied an overall adjustment of approximately 25 per cent, resulting in a final bonus outcome of £369.5m (a reduction of 3.6 per cent from the total outcome in 2013 (after adjusting for TSB)).

To ensure fairness for our shareholders, the total bonus outcome is subject to a limit of 10 per cent of pre-bonus Underlying Profit. For 2014, the bonus outcome of £369.5m is significantly below the limit of £813m.

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 2014 annual bonus for Executive Directors is deferred in shares until at least March 2017 and is in excess of deferral rates required by 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 Group has incorporated clawback, covering all Remuneration Code Staff, in line with PRA requirements. Vested variable remuneration can be recovered from employees up to seven years after the date of award in the case of a material or severe risk event. The option will be used alongside other performance adjustment processes and applies to variable remuneration awarded from 1 January 2015.

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 (LTIP) 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 2015 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 2014 the Committee consulted widely with various 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 2015 LTIP will comprise measures linked to the Group's strategic targets that reflect the wider Group objectives. These measures are customer satisfaction, active digital customer growth and colleague engagement.

Strategic focus	Measure	Basis of payout range	Metric	Weighting
Delivering sustainable growth	Absolute TSR	Growth in share price including dividends over 3 year period	Threshold: 8% pa Maximum: 16% pa	30%
Becoming simpler and more efficient	Economic Profit	Set relative to 2017 targets	Threshold: £2,870m Maximum: £3,587m	25%
	Cost: income ratio	Set relative to 2017 targets	Threshold: 45.6% Maximum: 44.5%	10%
Creating the best customer experience	Customer complaint handling (Total FCA reportable complaints per 1,000 accounts)[1] and Financial Ombudsman Service (FOS) uphold rate	Average performance over 3 year period	Threshold: 1.15 complaints per 1,000 accounts and 32% FOS uphold rate Maximum: 1.05 complaints per 1,000 accounts and 28% FOS uphold rate	10%
	Net promoter score	Major Group average ranking over 2017	Threshold: 3rd Maximum: 1st	10%
	Digital active customer growth	Set relative to 2017 targets	Threshold: 12.7m active users Maximum: 13.3m active users	7.5%
	Colleague engagement score	Set relative to 2017 targets	Threshold: 62% Maximum: 70%	7.5%

[1] Measure excludes PPI complaints and any complaints received via Claims Management Companies, but includes Banking, Home Finance, General Insurance, Life, Pensions and Investment complaints.

Remuneration disclosures continued

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, and ensures 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 Remuneration 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 and 2014 to ensure continued compliance with the Remuneration Code.

Further details on directors' remuneration and Board Governance can be found in the Governance section of the 2014 Lloyds Banking Group plc Annual Report and Accounts on pages 57 to 103.

Appendix 1: Lloyds Banking Group CRD IV Own Funds disclosure

OWN FUNDS DISCLOSURE TEMPLATE

Table 91:
Lloyds Banking Group Own Funds Template

As at 31 December 2014	Transitional Rules £m	Fully Loaded Rules £m
Common equity tier 1 (CET1) capital: instruments and reserves		
Capital instruments and related share premium accounts	24,427	24,427
of which: called up share capital	7,146	7,146
of which: share premium	17,281	17,281
Retained earnings	6,951	6,951
Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	11,474	11,474
Minority interests (amount allowed in consolidated CET1)	470	470
Foreseeable dividend	(535)	(535)
Common equity tier 1 (CET1) capital before regulatory adjustments	42,787	42,787
Common equity tier 1 (CET1) capital: regulatory adjustments		
Additional value adjustments	(329)	(329)
Intangible assets (net of related tax liability)	(1,875)	(1,875)
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)	(4,533)	(4,533)
Fair value reserves related to gains or losses on cash flow hedges	(1,139)	(1,139)
Negative amounts resulting from the calculation of expected loss amounts	(565)	(565)
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	73	73
Defined benefit pension fund assets	(909)	(909)
Direct and indirect holdings by the Group of own CET1 instruments	(64)	(64)
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)	(2,546)	(2,546)
Exposure amount of the following items which qualify for a risk weight of 1,250%, where the Group has opted for the deduction alternative	(211)	(211)
of which: securitisation positions	(211)	(211)
Total regulatory adjustments applied to common equity tier 1 (CET1)	(12,098)	(12,098)
Common equity tier 1 (CET1) capital	30,689	30,689
Additional tier 1 (AT1) capital: instruments		
Capital instruments and related share premium accounts	5,355	5,355
of which: classified as equity under applicable accounting standards	5,355	5,355
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	997	–
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	3,376	–
of which: instruments issued by subsidiaries subject to phase out	3,376	–
Additional tier 1 (AT1) capital before regulatory adjustments	9,728	5,355
Additional tier 1 (AT1) capital: regulatory adjustments		
Residual amounts deducted from AT1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to Article 475 of the CRR	(859)	–
of which: significant investments in Tier 2 instruments of other financial sector entities	(859)	–
Total regulatory adjustments applied to additional tier 1 (AT1) capital	(859)	–
Additional tier 1 (AT1) capital	8,869	5,355
Tier 1 capital	39,558	36,044

Appendix 1: Lloyds Banking Group CRD IV Own Funds disclosure continued

As at 31 December 2014	Transitional Rules £m	Fully Loaded Rules £m
Tier 2 (T2) capital: Instruments and provisions		
Capital instruments and related share premium accounts	716	1,713
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	10	–
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	13,471	9,123
of which: instruments issued by subsidiaries subject to phase out	4,523	–
Credit risk adjustments	333	333
Tier 2 (T2) capital before regulatory adjustments	14,530	11,169
Tier 2 (T2) capital: regulatory adjustments		
Direct and indirect holdings by the Group of the T2 instruments and subordinated loans of financial sector entities where the Group has a significant investment in those entities (net of eligible short positions)	(1,288)	(2,146)
Total regulatory adjustments applied to tier 2 (T2) capital	(1,288)	(2,146)
Tier 2 (T2) capital	13,242	9,023
Total capital	52,800	45,067
Total risk weighted assets	239,734	239,734
Capital ratios and buffers		
Common Equity Tier 1 (as a percentage of risk exposure amount)	12.8%	12.8%
Tier 1 (as a percentage of risk exposure amount)	16.5%	15.0%
Total capital (as a percentage of risk exposure amount)	22.0%	18.8%
Common Equity Tier 1 available to meet buffers (as a percentage of risk exposures)[1]	8.8%	8.3%
Amounts below the threshold for deduction (before risk weighting)		
Direct and indirect holdings of the capital of financial sector entities where the Group does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	1,092	1,092
Direct and indirect holdings by the Group of the CET1 instruments of financial sector entities where the Group has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	3,324	3,324
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in 38 (3) of the CRR are met)	1,006	1,006
Applicable caps on the inclusion of provisions in Tier 2		
Cap on inclusion of credit risk adjustments in T2 under standardised approach	749	749
Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	333	333
Cap on inclusion of credit risk adjustments in T2 under internal ratings-based approach	1,064	1,064
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)		
Current cap on AT1 instruments subject to phase out arrangements	4,407	–
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	316	–
Current cap on T2 instruments subject to phase out arrangements	9,448	–

[1] Excluding CET1 required to meet Pillar 2A requirements under fully loaded.

OWN FUNDS RECONCILIATION

The following table presents certain items from the Group's consolidated regulatory balance sheet (as presented on pages 9 to 10), for the year ended 31 December 2014, that are used to calculate own funds. Where necessary, the balance sheet components under the regulatory scope of consolidation have been expanded such that the components of the transitional own funds disclosure template appear separately.

Table 92:
Items extracted from the consolidated regulatory balance sheet

Balance Sheet Category	Items extracted from the consolidated regulatory balance sheet £m
Assets	
Investment in Scottish Widows subordinated debt at fair value through profit or loss	2,146
Other trading and other financial assets at fair value through profit or loss	58,343
Trading and other financial assets at fair value through profit or loss	60,489
Investment in group undertakings	5,932
Goodwill	194
Other intangible assets	1,915
Total goodwill and other intangible assets	2,109
Deferred tax assets	5,032
Retirement benefit assets	1,136
Liabilities	
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	1,091
Preference shares	1,091
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties.	3,768
Non eligible instruments	78
Preferred securities	3,846
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from Tier 2	10
Qualifying own funds instruments included in consolidated Tier 2 capital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	929
Non eligible instruments	29
Undated subordinated liabilities	968
Qualifying own funds instruments included in consolidated Tier 2 capital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	2,937
Non-eligible instruments	750
Enhanced Capital Notes	3,687
Tier 2 capital instruments and related share premium accounts	649
Qualifying own funds instruments included in consolidated Tier 2 capital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	12,360
Non eligible instruments	1,101
Dated subordinated liabilities	14,110
Subordinated liabilities	**23,702**
Equity	
Share capital	7,146
Share premium account	17,281
Cash flow hedging reserve	1,139
Merger and other reserves	11,000
Other reserves	12,139
Retained profits	6,173
Shareholders' equity	**42,739**
Other equity instruments	5,355
Total equity excluding non-controlling interests	**48,094**
Non-controlling interests	1,200
Total Equity	**49,294**

Appendix 1: Lloyds Banking Group CRD IV Own Funds disclosure continued

Table 93:
Reconciliation of own funds items to audited financial statements

As at 31 December 2014	Items extracted from the consolidated regulatory balance sheet £m	Own Funds £m	Difference	Note
Common Equity Tier 1 capital:				
Called up share capital	7,146	7,146	–	
Share premium	17,281	17,281	–	
Capital instruments and the related share premium accounts		24,427		
Retained earnings	6,173	6,951	778	Note 1
Accumulated other comprehensive income and other reserves (including unrealised gains or losses)	12,139	11,474	(665)	Note 1
Minority interests (amount allowed in consolidated CET1)	1,200	470	(730)	Note 2
Foreseeable dividend	–	(535)	(535)	Note 3
Common Equity Tier 1 (CET1) capital before regulatory adjustments		42,787		
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments		(329)	(329)	Note 4
Intangible assets (net of related tax liability), (negative amount)	(2,109)	(1,875)	234	Note 5
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) (negative amount)	(5,032)	(4,533)	499	Note 6
Fair value reserves related to gains or losses on cash flow hedges	(1,139)	(1,139)	–	
Negative amounts resulting from the calculation of expected loss amounts		(565)	(565)	Note 7
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing		73	73	Note 8
Defined benefit pension fund assets (negative amount)	(1,136)	(909)	227	Note 9
Direct and indirect holdings by the Group of own CET1 instruments		(64)	(64)	Note 10
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 the 10% threshold and net eligible short positions) (negative amount)	(5,932)	(2,546)	3,386	Note 11
Exposure amount of the following items which qualify for a risk weight of 1250%, where the Group opts for the deduction alternative		(211)	(211)	Note 12
Total regulatory adjustments to Common Equity Tier 1 (CET1)		(12,098)		
Common Equity Tier 1 (CET1) capital		30,689		
Additional Tier 1 (AT1) capital: instruments				
Capital instruments and the related share premium accounts	5,355	5,355	–	
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	1,091	997	(94)	Note 13
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties.	3,768	3,376	(392)	Note 14
Additional Tier 1 (AT1) capital before regulatory adjustments		9,728		
Additional Tier 1 (AT1) capital: regulatory adjustments				
Residual amounts deducted from AT1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to Article 475 of the CRR	(2,146)	(859)	1,287	Note 15
Total regulatory adjustments to Additional Tier 1 (AT1) capital		(859)		
Additional Tier 1 (AT1) capital		8,869		
Tier 1 capital		39,558		

As at 31 December 2014	Items extracted from the consolidated regulatory balance sheet £m	Own Funds £m	Difference	Note
Tier 2 (T2) Capital: Instruments and Provisions				
Capital instruments and related share premium accounts	**649**	**716**	67	Note 16
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	**10**	**10**	–	
Qualifying own funds instruments included in consolidated T2 capital (including minority interest and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	**16,226**	**13,471**	(2,755)	Note 17
Credit risk adjustments		**333**	333	Note 18
Tier 2 (T2) capital before regulatory adjustments		**14,530**		
Tier 2 (T2) capital: regulatory adjustments				
Direct and indirect holdings by the Group of the T2 instruments and subordinated loans of financial sector entities where the Group has a significant investment in those entities (net of eligible short positions) (negative amount)	**(2,146)**	**(1,288)**	858	Note 15
Total regulatory adjustments to Tier 2 (T2) capital		**(1,288)**		
Tier 2 (T2) capital		**13,242**		
Total capital		**52,800**		

[1] The regulatory definition of eligible items for inclusion in retained earnings differs from the statutory reporting definition. The aggregate of retained earnings and accumulated other comprehensive income and other reserves is comparable on both bases but the allocation between categories differs.

[2] The £470m remaining in own funds reflects the minority interest in TSB Bank Plc as eligible under the CRD IV rules (subject to certain restrictions).

[3] The £535m foreseeable dividend is that recommended by the Board of Directors in respect of 2014 earnings.

[4] The additional value adjustments of £329m reflect the prudent valuation adjustment for all assets measured at fair value in accordance with Articles 34 and 105 of the CRR.

[5] The CRD IV rules require the amount deducted from own funds to be reduced by the amount of the associated deferred tax liabilities. A reconciliation from the gross amounts to the amount net of the associated deferred tax liability is presented in the table below.

	31 December 2014 £m
Goodwill as presented on the consolidated regulatory balance sheet, page 129	194
Intangible assets as presented on the consolidated regulatory balance sheet, page 129	1,915
Total goodwill and intangible assets as presented on the consolidated regulatory balance sheet, page 129	2,109
Deferred tax liability related to certain intangible assets	(234)
Intangible assets (net of related tax liability) as presented in own funds	1,875

[6] The deferred tax assets as presented in the regulatory consolidated balance sheet represent all of the Group's deferred tax assets. The own funds deduction of £4,533m for deferred tax excludes the deferred tax balances for intangible assets and the defined benefit pension fund asset. Additionally, only the deferred tax amounts that rely on future profitability are required to be deducted from CET1, and may be reduced by associated deferred tax liabilities where conditions specified in Article 38 of the CRR are met. The deferred tax assets related to temporary differences form part of the Group's gross drawn credit risk exposures as presented on page 11.

[7] In accordance with Articles 36, 62, 158 and 159 of the CRR the excess of expected losses over specific credit risk adjustments (SCRAs) and additional value adjustments in relation to risk-weighted exposure amounts calculated using the Internal Ratings Based approach, of £565m, are deducted from CET1. A comparison of regulatory expected losses to SCRAs on loans and receivables, in respect of credit risk exposures subject to the IRB Approach is presented on pages 51 to 52.

[8] CRD IV requires the removal of the impact of any gains or losses recorded on liabilities held at fair value through profit or loss or derivative liabilities due to changes in the credit spreads of Lloyds Bank plc.

[9] CRD IV requires the amount of the retirement benefit asset deducted from own funds to be reduced by the amount of the associated deferred tax liabilities. A reconciliation from the gross amount to the amount net of the associated deferred tax liability is presented in the table below.

	31 December 2014 £m
Retirement benefit asset as presented on the consolidated regulatory balance sheet, page 129	1,136
Deferred tax liability	(227)
Defined benefit pension fund assets (net of related tax liability) as presented in own funds	909

[10] The £64m deduction for holdings by the Group of its own CET1 instruments represents the regulatory adjustment required to remove the Group's investment in its own shares, excluding holdings through Open Ended Investment Company's (OEICs) as these shareholdings are held for third party investors through the Group's Insurance operations.

[11] The investment in group undertakings of £5,932m extracted from the consolidated regulatory balance sheet represents the Group's total equity investment in Insurance subsidiaries as well as joint ventures and associates. The majority of the investment relates to the Group's investment in its Insurance operations (headed by Scottish Widows plc). The own funds deduction of £2,546m reflects the regulatory requirement to deduct a portion of the Group's significant investments from CET1, above certain thresholds. In accordance with the CRD IV rules the cost of the Group's investment in the equity of the Insurance business is risk-weighted up to a limit based on the size of the Group's CET1 (included in the gross drawn credit risk exposures on page 11), with the remainder deducted from CET1.

[12] The £211m deduction for securitisation positions reflects those positions that were rated below BB- or that are unrated.

Appendix 1: Lloyds Banking Group CRD IV Own Funds disclosure continued

[13] The £997m of AT1 instruments and the related share premium presented in own funds reflect instruments issued by Lloyds Banking Group plc that qualified as Tier 1 under the regulations that preceded CRD IV, subject to certain restrictions, including a cap set at 80% of the value of such instruments that were in issue at 31 December 2012 and net of interest. Any excess over the cap is included in Tier 2 capital, see note 16 below. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Preference shares issued by the Group as presented on the consolidated regulatory balance sheet, page 129	1,091
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	(71)
Accrued interest and other adjustments	(23)
Qualifying items and related share premium accounts subject to phase out from AT1 as presented in own funds	997

[14] The £3,376m of AT1 instruments presented in own funds reflect instruments issued by subsidiaries and held by third parties that qualified as Tier 1 under the regulations that preceded CRD IV, subject to certain restrictions, including a cap set at 80% of the value of such instruments that were in issue at 31 December 2012 and net of interest. Any excess over the cap is included in Tier 2 capital, see note 17 below. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Preferred securities issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 129	3,768
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	(245)
Accrued interest and other adjustments	(147)
Qualifying items issued by subsidiaries subject to phase out from AT1 as presented in own funds	3,376

[15] The £2,146m extracted from the regulatory consolidated balance sheet reflects the Group's investment in the subordinated debt of Scottish Widows held at fair value through profit or loss. The Group's full investment in the subordinated debt of Scottish Widows is deducted from capital across AT1 and T2 in accordance with the transitional CRD IV rules. For 2014, 80% is deducted equally from AT1 and T2, with the remainder deducted directly from Tier 2 capital. The deductions from each tier of capital are presented in the table below.

	31 December 2014 £m
Amount deducted from AT1, subject to phase out, as presented in own funds	859
Amount deducted from T2, as presented in own funds	1,288
Other adjustments	(1)
Total direct and indirect holdings of Scottish Widows subordinated debt held at fair value through profit or loss deducted from capital	2,146

[16] The £716m of T2 instruments and the related share premium accounts presented in own funds reflect qualifying subordinated debt instruments issued by Lloyds Banking Group plc net of interest. It includes any amounts in excess of AT1 caps that are given recognition in T2, as identified in note 13 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Dated subordinated debt issued by the Group as presented on the consolidated regulatory balance sheet, page 129	649
Instruments excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	71
Accrued interest and other adjustments	(4)
Qualifying items and related share premium accounts as presented in own funds	716

[17] The £13,471m of T2 instruments presented in own funds reflect qualifying subordinated debt instruments issued by subsidiaries and held by third parties net of interest, amortisation and associated derivatives. It includes any amounts in excess of AT1 caps that are given recognition in T2, as identified in note 14 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Dated subordinated debt issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 129	12,360
Undated subordinated debt issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 129	929
Enhanced Capital Notes issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 129	2,937
Total subordinated debt instruments issued by subsidiaries that are given recognition in T2	16,226
Instruments excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	245
Accrued interest, amortisation, associated derivatives and other adjustments	(3,000)
Qualifying items issued by subsidiaries as presented in own funds	13,471

[18] Credit risk adjustments of £333m reflect the surplus provisions resulting from the calculation of excess expected loss amounts in accordance with Articles 158 and 159 of the CRR, subject to certain limits. A comparison of regulatory expected losses to SCRAs on loans and receivables, in respect of credit risk exposures subject to the IRB Approach is presented on pages 51 to 52.

Appendix 2: Lloyds Bank Group

OWN FUNDS DISCLOSURE TEMPLATE

Table 94:
Lloyds Bank Group Own Funds Template

As at 31 December 2014	Transitional Rules £m	Fully Loaded Rules £m
Common equity tier 1 (CET1) capital: instruments and reserves		
Capital instruments and related share premium accounts	37,107	37,107
of which: called up share capital	1,574	1,574
of which: share premium	35,533	35,533
Retained earnings	5,676	5,676
Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	5,478	5,478
Minority interests (amount allowed in consolidated CET1)	470	470
Foreseeable dividend	(540)	(540)
Common equity tier 1 (CET1) capital before regulatory adjustments	48,191	48,191
Common equity tier 1 (CET1) capital: regulatory adjustments		
Additional value adjustments	(329)	(329)
Intangible assets (net of related tax liability)	(1,875)	(1,875)
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)	(4,533)	(4,533)
Fair value reserves related to gains or losses on cash flow hedges	(1,357)	(1,357)
Negative amounts resulting from the calculation of expected loss amounts	(565)	(565)
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	73	73
Defined benefit pension fund assets	(909)	(909)
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)	(2,021)	(2,021)
Exposure amount of the following items which qualify for a risk weight of 1,250%, where the Group has opted for the deduction alternative	(211)	(211)
of which: securitisation positions	(211)	(211)
Total regulatory adjustments applied to common equity tier 1 (CET1)	(11,727)	(11,727)
Common equity tier 1 (CET1) capital	36,464	36,464
Additional tier 1 (AT1) capital: instruments		
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	3,990	–
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	1,452	–
of which: instruments issued by subsidiaries subject to phase out	1,452	–
Additional tier 1 (AT1) capital before regulatory adjustments	5,442	–
Additional tier 1 (AT1) capital: regulatory adjustments		
Residual amounts deducted from AT1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to Article 475 of the CRR	(859)	–
of which: significant investments in Tier 2 instruments of other financial sector entities	(859)	–
Total regulatory adjustments applied to additional tier 1 (AT1) capital	(859)	–
Additional tier 1 (AT1) capital	4,583	–
Tier 1 capital	41,047	36,464

Appendix 2: Lloyds Bank Group continued

As at 31 December 2014	Transitional Rules £m	Fully Loaded Rules £m
Tier 2 (T2) capital: Instruments and provisions		
Capital instruments and related share premium accounts	11,525	13,700
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	1,470	–
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	3,161	1,840
of which: instruments issued by subsidiaries subject to phase out	1,451	–
Credit risk adjustments	333	333
Tier 2 (T2) capital before regulatory adjustments	16,489	15,873
Tier 2 (T2) capital: regulatory adjustments		
Direct and indirect holdings by the Group of the T2 instruments and subordinated loans of financial sector entities where the Group has a significant investment in those entities (net of eligible short positions)	(1,288)	(2,146)
Total regulatory adjustments applied to tier 2 (T2) capital	(1,288)	(2,146)
Tier 2 (T2) capital	15,201	13,727
Total capital	56,248	50,191
Total risk weighted assets	241,046	241,046
Capital ratios and buffers		
Common Equity Tier 1 (as a percentage of risk exposure amount)	15.1%	15.1%
Tier 1 (as a percentage of risk exposure amount)	17.0%	15.1%
Total capital (as a percentage of risk exposure amount)	23.3%	20.8%
Common Equity Tier 1 available to meet buffers (as a percentage of risk exposures)[1]	11.1%	10.6%
Amounts below the threshold for deduction (before risk weighting)		
Direct and indirect holdings of the capital of financial sector entities where the Group does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	1,212	1,212
Direct and indirect holdings by the Group of the CET1 instruments of financial sector entities where the Group has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	3,848	3,848
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in 38 (3) of the CRR are met)	1,006	1,006
Applicable caps on the inclusion of provisions in Tier 2		
Cap on inclusion of credit risk adjustments in T2 under standardised approach	749	749
Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	333	333
Cap on inclusion of credit risk adjustments in T2 under internal ratings-based approach	1,064	1,064
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)		
Current cap on AT1 instruments subject to phase out arrangements	5,442	–
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	646	–
Current cap on T2 instruments subject to phase out arrangements	3,279	–

[1] Excluding CET1 required to meet Pillar 2A requirements under fully loaded.

OWN FUNDS RECONCILIATION

The following table provides a reconciliation, for certain items that are used to calculate own funds, from the Lloyds Bank Group consolidated balance sheet on an accounting consolidation basis (as presented on pages 15 to 16 of the 2014 Lloyds Bank plc Annual Report and Accounts) to the Lloyds Bank Group consolidated balance sheet under the regulatory scope of consolidation for the year ended 31 December 2014. Where necessary, the balance sheet components under the regulatory scope of consolidation have been expanded such that the components of the transitional own funds disclosure template appear separately.

Table 95:
Lloyds Bank Group items extracted from the consolidated regulatory balance sheet

Balance Sheet Category	Consolidated accounting balance sheet £m	Deconsolidated entities (Insurance/ other) and regulatory reallocations[1] £m	Consolidated regulatory balance sheet £m
Assets			
Investment in Scottish Widows subordinated debt at fair value through profit or loss			2,146
Other trading and other financial assets at fair value through profit or loss			58,932
Trading and other financial assets at fair value through profit or loss	152,520	(91,442)	61,078
Investment in group undertakings	–	5,932	5,932
Goodwill			194
Other intangible assets			1,915
Total goodwill and other intangible assets	4,086	(1,977)	2,109
Deferred tax assets	4,190	(279)	5,077
Retirement benefit assets	1,147	(11)	1,136
Liabilities			
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1			2,444
Preference shares	2,444	–	2,444
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1			2,133
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties.			1,635
Non eligible instruments			78
Preferred securities	3,821	25	3,846
Tier 2 capital instruments and related share premium accounts			684
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2			123
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			236
Non eligible instruments			29
Undated subordinated liabilities	2,486	(1,414)	1,072
Tier 2 capital instruments and related share premium accounts			14,918
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2			1,146
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			4,305
Non eligible instruments			1,250
Dated subordinated liabilities	23,222	(1,603)	21,619
Subordinated liabilities	**31,973**	**(2,992)**	**28,981**

Appendix 2: Lloyds Bank Group continued

Balance Sheet Category	Consolidated accounting balance sheet £m	Deconsolidated entities (Insurance/ other) and regulatory reallocations[1] £m	Consolidated regulatory balance sheet £m
Equity			
Share capital	1,574	–	1,574
Share premium account	35,533	–	35,533
Cash flow hedging reserve			1,357
Other reserves			4,408
Other reserves	6,842	(1,077)	5,765
Retained profits	4,828	481	5,309
Shareholders' equity excluding non-controlling interests	48,777	(596)	48,181
Non-controlling interests	1,213	(13)	1,200
Total Equity	49,990	(609)	49,381

[1] As insurance undertakings are excluded from the scope of the Lloyds Bank Group's regulatory consolidation, assets and liabilities relating to the Lloyds Bank 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. Additionally, regulatory reallocations are made in accordance with PRA reporting requirements that require certain balances to be re-categorised.

Table 96:
Lloyds Bank Group reconciliation of own funds items to audited financial statements

As at 31 December 2014	Items extracted from the consolidated regulatory balance sheet £m	Own Funds £m	Difference	Note
Common Equity Tier 1 capital:				
Called up share capital	1,574	1,574	–	
Share premium	35,533	35,533	–	
Capital instruments and the related share premium accounts		37,107		
Retained earnings	5,309	5,676	367	Note 1
Accumulated other comprehensive income and other reserves (including unrealised gains or losses)	5,765	5,478	(287)	Note 1
Minority interests (amount allowed in consolidated CET1)	1,200	470	(730)	Note 2
Foreseeable dividend	–	(540)	(540)	Note 3
Common Equity Tier 1 (CET1) capital before regulatory adjustments		48,191		
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments		(329)	(329)	Note 4
Intangible assets (net of related tax liability), (negative amount)	(2,109)	(1,875)	234	Note 5
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) (negative amount)	(5,077)	(4,533)	544	Note 6
Fair value reserves related to gains or losses on cash flow hedges	(1,357)	(1,357)	–	
Negative amounts resulting from the calculation of expected loss amounts		(565)	(565)	Note 7
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing		73	73	Note 8
Defined benefit pension fund assets (negative amount)	(1,136)	(909)	227	Note 9
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 the 10% threshold and net eligible short positions) (negative amount)	(5,932)	(2,021)	3,911	Note 10
Exposure amount of the following items which qualify for a risk weight of 1250%, where the Group opts for the deduction alternative		(211)	(211)	Note 11
Total regulatory adjustments to Common Equity Tier 1 (CET1)		(11,727)		
Common Equity Tier 1 (CET1) capital		36,464		

As at 31 December 2014	Items extracted from the consolidated regulatory balance sheet £m	Own Funds £m	Difference	Note
Additional Tier 1 (AT1) capital: instruments				
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	4,577	3,990	(587)	Note 12
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issue by subsidiaries and held by third parties.	1,635	1,452	(183)	Note 13
Additional Tier 1 (AT1) capital before regulatory adjustments		5,442		
Additional Tier 1 (AT1) capital: regulatory adjustments				
Residual amounts deducted from AT1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to Article 475 of the CRR	(2,146)	(859)	1,287	Note 14
Total regulatory adjustments to Additional Tier 1 (AT1) capital		(859)		
Additional Tier 1 (AT1) capital		4,583		
Tier 1 capital		41,047		
Tier 2 (T2) Capital: Instruments and Provisions				
Capital instruments and related share premium accounts	15,602	11,525	(4,077)	Note 15
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	1,269	1,470	201	Note 16
Qualifying own funds instruments included in consolidated T2 capital (including minority interest and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	4,541	3,161	(1,380)	Note 17
Credit risk adjustments		333	333	Note 18
Tier 2 (T2) capital before regulatory adjustments		16,489		
Tier 2 (T2) capital: regulatory adjustments				
Direct and indirect holdings of the Group of the T2 instruments and subordinated loans of financial sector entities where the Group has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	(2,146)	(1,288)	858	Note 14
Total regulatory adjustments to Tier 2 (T2) capital		(1,288)		
Tier 2 (T2) capital		15,201		
Total capital		56,248		

[1] The regulatory definition of eligible items for inclusion in retained earnings differs from the statutory reporting definition. The aggregate of retained earnings and accumulated other comprehensive income and other reserves is comparable with those on both bases but the allocation between categories differ.

[2] The £470m remaining in own funds reflects the minority interest in TSB Bank Plc as eligible under the CRD IV rules (subject to certain restrictions).

[3] The £540m foreseeable dividend is that recommended by the Board of Directors in respect of 2014 earnings.

[4] The additional value adjustments of £329m reflect the prudent valuation adjustment for all assets measured at fair value in accordance with Articles 34 and 105 of the CRR.

[5] The CRD IV rules require the amount deducted from own funds to be reduced by the amount of the associated deferred tax liablities. A reconciliation from the gross amounts to the amount net of the associated deferred tax liability is presented in the table below.

	31 December 2014 £m
Goodwill as presented on the consolidated regulatory balance sheet, page 135	194
Intangible assets as presented on the consolidated regulatory balance sheet, page 135	1,915
Total goodwill and intangible assets as presented on the consolidated regulatory balance sheet, page 135	2,109
Deferred tax liability related to certain intangible assets	(234)
Intangible assets (net of related tax liability) as presented in own funds	1,875

[6] The deferred tax assets as presented in the regulatory consolidated balance sheet represent all of the Lloyds Bank Group deferred tax assets. The own funds deduction of £4,533m for deferred tax excludes the deferred tax balances for intangible assets and the defined benefit pension fund asset. Additionally, only the deferred tax amounts that rely on future profitability are required to be deducted from CET1, and may be reduced by associated deferred tax liabilities where conditions specified in Article 38 of the CRR are met. The deferred tax assets related to temporary differences form part of the Group's gross drawn credit risk exposures.

[7] In accordance with Articles 36, 62, 158 and 159 of the CRR the excess of expected losses over specific credit risk adjustments (SCRAs) and additional value adjustments in relation to risk-weighted exposure amounts calculated using the Internal Ratings Based approach, of £565m, are deducted from CET1.

[8] CRD IV requires the removal of the impact of any gains or losses recorded on liabilities held at fair value through profit or loss or derivative liabilities due to changes in the credit spreads of Lloyds Bank plc.

Appendix 2: Lloyds Bank Group continued

[9]CRD IV requires the amount of the retirement benefit asset deducted from own funds to be reduced by the amount of the associated deferred tax liabilities. A reconciliation from the gross amount to the amount net of the associated deferred tax liability is presented in the table below.

	31 December 2014 £m
Retirement benefit asset as presented on the consolidated regulatory balance sheet, page 135	1,136
Deferred tax liability	(227)
Defined benefit pension fund assets (net of related tax liability) as presented in own funds	909

[10]The investment in group undertakings of £5,932m extracted from the consolidated regulatory balance sheet represents the Lloyds Bank Group total equity investment in Insurance subsidiaries as well as joint ventures and associates. The majority of the investment relates to the Lloyds Bank Group investment in its Insurance operations (headed by Scottish Widows plc). The own funds deduction of £2,021m reflects the regulatory requirement to deduct only a portion of the Lloyds Bank Group significant investments from CET1, above certain thresholds. In accordance with the CRD IV rules the cost of the Lloyds Bank Group investment in the equity of the Insurance business is risk-weighted up to a limit based on the size of the Lloyds Bank Group CET1 (included in the gross drawn credit risk exposures), with the reminder deducted from CET1.

[11] The £211m deduction for securitisation positions reflects those positions that were rated below BB- or that are unrated.

[12]The £3,990m of AT1 instruments and the related share premium presented in own funds reflect certain instruments issued by Lloyds Bank plc that qualified as Tier 1 under the regulations that preceded CRD IV, subject to certain restrictions, including a cap set at 80% of the value of such instruments that were in issue at 31 December 2012 and net of interest. Any excess over the cap is included in Tier 2 capital, see notes 15 and 16 below. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Preference shares issued by Lloyds Bank Group as presented on the consolidated regulatory balance sheet, page 135	2,444
Preferred securities issued by Lloyds Bank Group as presented on the consolidated regulatory balance sheet, page 135	2,133
Total preference shares and preferred securities that are given recognition in AT1	4,577
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	(473)
Accrued interest and other adjustments	(114)
Qualifying items and related share premium accounts subject to phase out from AT1 as presented in own funds	3,990

[13]The £1,452m of AT1 instruments presented in own funds reflect instruments issued by subsidiaries and held by third parties, that qualified as Tier 1 under the regulations that preceded CRD IV, subject to certain restrictions, including a cap set at 80% of the value of such instruments that were in issue at 31 December 2012 and net of interest. Any excess over the cap is included in Tier 2 capital, see note 17 below. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Preferred securities issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 135	1,635
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	(173)
Accrued interest and other adjustments	(10)
Qualifying items issued by subsidiaries subject to phase out from AT1 as presented in own funds	1,452

[14]The £2,146m extracted from the regulatory consolidated balance sheet reflects the Group's investment in the subordinated debt of Scottish Widows held at fair value through profit or loss. The Group's full investment in the subordinated debt of Scottish Widows is deducted from capital across AT1 and T2 in accordance with the transitional CRD IV rules. For 2014, 80% is deducted equally from AT1 and T2, with the remainder deducted directly from Tier 2 capital. The deductions from each tier of capital are presented in the table below.

	31 December 2014 £m
Amount deducted from AT1, subject to phase out, as presented in own funds	859
Amount deducted from T2, as presented in own funds	1,288
Other adjustments	(1)
Total direct and indirect holdings of Scottish Widows subordinated debt held at fair value through profit or loss deducted from capital	2,146

[15] The £11,525m of T2 instruments and the related share premium presented in own funds reflect qualifying subordinated debt instruments issued by Lloyds Bank Group net of interest and amortisation. It includes any amounts in excess of AT1 caps that are given recognition in T2, as identified in note 12 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Dated subordinated debt issued by Lloyds Bank Group as presented on the consolidated regulatory balance sheet, page 135	14,918
Undated subordinated debt issued by Lloyds Bank Group as presented on the consolidated regulatory balance sheet, page 135	684
Total dated and undated subordinated debt issued by Lloyds Bank Group that is given recognition in T2	15,602
Instruments excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	258
Accrued interest, amortisation and other adjustments	(4,335)
Qualifying items and related share premium accounts as presented in own funds	11,525

[16] The £1,470m of T2 instruments and the related share premium presented in own funds reflect qualifying subordinated debt instruments issued by the Lloyds Bank plc net of interest. It includes any amounts in excess of AT1 caps that are given recognition in T2, as identified in note 12 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Dated subordinated debt issued by Lloyds Bank Group as presented on the consolidated regulatory balance sheet, page 135	1,146
Undated subordinated debt issued by Lloyds Bank Group as presented on the consolidated regulatory balance sheet, page 135	123
Total dated and undated subordinated debt issued by Lloyds Bank Group that is given recognition in T2	1,269
Instruments excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	215
Accrued interest and other adjustments	(14)
Qualifying items and related share premium accounts subject to phase out from T2 as presented in own funds	1,470

[17] The £3,161m of T2 instruments presented in own funds reflect qualifying subordinated debt instruments issued by subsidiaries and held by third parties net of interest and amortisation. It includes any amounts in excess of AT1 caps that are given recognition in T2, as identified in note 13 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Dated subordinated debt issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 135	4,305
Undated subordinated debt issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 135	236
Total dated and undated subordinated debt issued by subsidiaries that is given recognition in T2	4,541
Instruments issued by subsidiaries excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	173
Accrued interest, amortisation and other adjustments	(1,553)
Qualifying items issued by subsidiaries as presented in own funds	3,161

[18] Credit risk adjustments of £333m reflect the surplus provisions resulting from the calculation of excess expected loss amounts in accordance with Articles 158 and 159 of the CRR, subject to certain limits.

Appendix 2: Lloyds Bank Group continued

CAPITAL REQUIREMENTS

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 2014 are £241,046m (2013: £263,850m) and £19,284m (2013: £21,108m) respectively. Presented in the table below are the credit risk-weighted assets and associated Pillar 1 capital requirements.

Table 97:
Lloyds Bank Group capital requirements

	2014 Risk-weighted assets £m	2014 Pillar 1 capital requirements £m
CREDIT RISK		
Exposures subject to the IRB approach		
Foundation IRB approach		
Corporate – main	43,735	3,499
Corporate – SME	9,637	771
Corporate – specialised lending	5	–
Central governments and central banks	1,618	129
Institutions	1,577	126
Retail IRB approach		
Retail mortgages	43,123	3,450
of which: residential mortgages (SME)	3,174	254
of which: residential mortgages (non-SME)	39,949	3,196
Qualifying revolving retail exposures	14,061	1,125
Other SME	1,982	159
Other non-SME	13,720	1,098
Other IRB approaches		
Corporate – specialised lending	15,821	1,266
Equities – exchange traded	1,976	158
Equities – private equity	5,727	458
Equities – other	201	16
Securitisation positions	2,373	190
Non-credit obligation assets	5,047	404
Total – IRB approach	160,603	12,849
Exposures subject to the standardised approach		
Central governments and central banks	11	1
Public sector entities	9	1
Institutions	53	4
Corporates	13,646	1,092
Retail	2,946	236
Secured by mortgages on immovable property	3,408	273
of which: residential property	3,396	272
of which: commercial property	12	1
Exposures in default	1,573	126
Exposures associated with particularly high risk	1	–
Other items	3,797	304
Total – standardised approach	25,444	2,037
Contributions to the default fund of a central counterparty	515	41
Total credit risk	186,562	14,927

	2014 Risk-weighted assets £m	2014 Pillar 1 capital requirements £m
Threshold – significant investments	9,623	770
Threshold – deferred tax	2,515	201
Total credit risk	**198,700**	**15,898**

ANALYSIS OF CREDIT RISK MITIGATION

The following table provides an analysis of 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.

Table 98:
Lloyds Bank Group: Eligible financial collateral and other eligible collateral

	2014 Exposures covered by eligible financial collateral £m	2014 Exposures covered by other eligible collateral £m	2014 Total £m
Exposures subject to the IRB Approach			
Foundation IRB Approach			
Corporate – Main	955	9,138	10,093
Corporate – SME	29	7,608	7,637
Institutions	567	–	567
Other IRB Approach			
Corporate – Specialised lending	718	–	718
Total – IRB Approach	**2,269**	**16,746**	**19,015**
Exposures subject to the Standardised Approach			
Corporates	669	–	669
Exposures in default	2	–	2
Total	**2,940**	**16,746**	**19,686**

Unfunded credit protection : Guarantees and credit derivatives

Protection Provider	2014 Credit protection provided in the form of guarantees £m	2014 Credit protection provided in the form of credit derivatives £m	2014 Total £m
Exposures subject to the IRB Approach			
Central governments and central banks	5	–	5
Institutions	100	48	148
Corporates	333	–	333
Exposures subject to the Standardised Approach			
Central governments and central banks	188	83	271
Total	**626**	**131**	**757**

Appendix 2: Lloyds Bank Group continued

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.

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 2014, by major industrial sector, is provided in the table below.

Table 99:
Lloyds Bank Group past due but not impaired and impaired loans and advances analysed by major industrial sector

	Past due but not impaired		Impaired	
	2014 £m	2014 As a % of Credit Risk Exposure	2014 £m	2014 As a % of Credit Risk Exposure
Agriculture, forestry and fishing	123	1.74%	100	1.41%
Energy and water supply	3	0.06%	145	2.80%
Manufacturing	3	0.02%	201	1.27%
Construction	261	5.05%	840	16.24%
Transport, distribution and hotels	116	0.51%	1,681	7.34%
Postal and communications	–	–	353	10.65%
Property companies	56	0.15%	3,769	10.38%
Financial, business and other services	204	0.11%	1,381	0.75%
Personal: Mortgages	10,311	2.87%	4,344	1.21%
Personal: Other	312	0.65%	1,418	2.96%
Lease financing	4	0.11%	1	0.03%
Hire purchase	80	1.10%	75	1.03%
Total	11,473	1.61%	14,308	2.01%

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 2014, by geographical region, based on the country of residence of the customer, is provided in the table below.

Table 100:
Lloyds Bank Group past due but not impaired and impaired loans and advances analysed by geographical region

	Past due but not impaired		Impaired	
	2014 £m	2014 As a % of Credit Risk Exposure	2014 £m	2014 As a % of Credit Risk Exposure
United Kingdom	10,891	1.75%	10,402	1.68%
Rest of Europe	540	1.40%	3,595	9.32%
United States of America	–	–	82	0.26%
Asia-Pacific	41	1.77%	137	5.90%
Other	1	0.02%	92	1.88%
Total	11,473	1.61%	14,308	2.01%

ANALYSIS OF SPECIFIC CREDIT RISK ADJUSTMENTS (SCRA'S) 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 2013 to 31 December 2014, in respect of loans and advances to customers is provided below.

Table 101:
Lloyds Bank Group movement in impairment provisions (loans and advances to customers)

	£m
At 31 December 2013	11,966
Exchange and other adjustments	(410)
Advances written off	(6,432)
Recoveries of advances written off in previous years	681
Unwinding of discount	(126)
Charge to the income statement	735
At 31 December 2014	**6,414**
(Lloyds Bank plc Annual Report and Accounts 2014, page 53)	

Table 102:
Lloyds Bank Group movement in acquisition related fair value adjustments (loans and advances to customers)

	£m
At 31 December 2013	668
Fair value unwind[1]:	
in respect of impairment losses	(245)
other, including market liquidity	(30)
At 31 December 2014	**393**

[1] The fair value adjustments relating to loans and advances were those required to reflect the HBOS assets in the Group's consolidated financial records at their fair value and took into account both the expected losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires significant management judgement to determine its timing which includes an assessment of whether the losses incurred in the current period were expected at the date of acquisition and assessing whether the remaining losses expected at the date of acquisition will still be incurred. The element related to market liquidity unwinds to the income statement over the estimated expected lives of the related assets although if an asset is written-off or suffers previously unexpected impairment then this element of the fair value will no longer be considered a timing difference (liquidity) but permanent (impairment). The fair value unwind in respect of impairment losses incurred for loans and advances to customers within portfolios applying the internal ratings based approach was £245m for the period ended 31 December 2014.

Appendix 2: Lloyds Bank Group continued

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.

Table 103:
Lloyds Bank Group impairment provisions, net charge and acquisition related fair value adjustments analysed by major industrial sector

	2014 Impairment provisions £m	2014 Net charge £m	2014 Acquisition related fair value adjustments £m
Agriculture, forestry and fishing	18	2	–
Energy and water supply	61	28	–
Manufacturing	179	(4)	–
Construction	158	(81)	–
Transport, distribution and hotels	1,051	198	–
Postal and communications	17	6	–
Property companies	2,553	40	–
Financial, business and other services	1,225	179	–
Personal: mortgages	460	(138)	393
Personal: other	607	536	–
Lease financing	1	(1)	–
Hire purchase	84	(30)	–
Total	6,414	735	393

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 104:
Lloyds Bank Group impairment provisions, net charge and acquisition related fair value adjustments analysed by geographical region

	2014 Impairment provisions £m	2014 Net charge £m	2014 Acquisition related fair value adjustments £m
United Kingdom	4,575	842	393
Rest of Europe	2,848	329	–
United States of America	87	5	–
Asia-Pacific	52	4	–
Other	90	3	–
Total	7,652	1,183	393
Fair value and other adjustments[1]	(1,238)	(448)	
Total	6,414	735	393

[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.

ANALYSIS OF CREDIT RISK EXPOSURES

Table 105:

Lloyds Bank Group credit risk exposures

Exposure Class	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2014 Average credit risk exposure £m
Exposures subject to the IRB approach				
Foundation IRB approach				
Corporate – main	80,496	43,735	54%	83,802
Corporate – SME	13,979	9,637	69%	14,472
Corporate – specialised lending	11	5	42%	87
Central governments and central banks	15,714	1,618	10%	21,393
Institutions	7,970	1,577	20%	6,651
Retail IRB approach				
Retail mortgages	359,326	43,123	12%	362,647
of which: residential mortgages (SME)	11,114	3,174	29%	11,170
of which: residential mortgages (non-SME)	348,212	39,949	11%	351,477
Qualifying revolving retail exposures	36,287	14,061	39%	37,551
Other SME	2,736	1,982	72%	2,827
Other non-SME	14,599	13,720	94%	13,681
Other IRB approaches				
Corporate – specialised lending	22,420	15,821	71%	28,266
Equities – exchange traded	682	1,976	290%	563
Equities – private equity	3,014	5,727	190%	2,930
Equities – other	54	201	370%	96
Securitisation positions	14,351	2,373	17%	13,794
Non-credit obligation assets	8,441	5,047	60%	1,677
Total – IRB approach	580,080	160,603	28%	590,437
Exposures subject to the standardised approach				
Central governments and central banks	83,617	11	–	79,221
Regional governments or local authorities	–	–	–	7
Public sector entities	9	9	100%	10
Institutions	205	53	26%	790
Corporates	26,976	13,646	51%	32,369
Retail	4,316	2,946	68%	4,555
Secured by mortgages on immovable property	9,575	3,408	36%	8,476
of which: residential property	9,563	3,396	36%	8,426
of which: commercial property	12	12	100%	50
Exposures in default	1,339	1,573	117%	2,117
Exposures associated with particularly high risk	1	1	150%	1
Short term claims on institutions and corporates	–	–	–	259
Collective investment undertakings (CIUs)	–	–	–	14
Other items	5,404	3,797	70%	7,735
Total – standardised approach	131,442	25,444	19%	135,554
Contributions to the default fund of a central counterparty	143	515	360%	101
Total Credit Risk	711,665	186,562	26%	726,092

Appendix 2: Lloyds Bank Group continued

Exposure Class	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2014 Average credit risk exposure £m
Threshold – significant investments	3,849	9,623	250%	3,766
Threshold – deferred tax	1,006	2,515	250%	1,184
Total Credit Risk	716,520	198,700	28%	731,042

ANALYSIS OF CREDIT RISK EXPOSURES BY INDUSTRY

Credit risk exposures as at 31 December 2014, analysed by major industrial sector, are provided in the table below.

Table 106:
Lloyds Bank Group credit risk exposure analysed by major industrial sector

	2014 Agriculture, forestry and fishing £m	2014 Energy and water supply £m	2014 Manufacturing £m	2014 Construction £m	2014 Transport, distribution and hotels £m	2014 Postal and comms £m	2014 Property companies £m	2014 Financial, business and other services £m	2014 Personal: mortgages £m	2014 Personal: other £m	2014 Lease financing £m	2014 Hire purchase £m	2014 Total £m
Exposures subject to the IRB approach													
Foundation IRB approach													
Corporate – main	172	3,761	11,921	2,949	12,396	2,511	10,764	31,467	–	3	2,617	1,935	80,496
Corporate – SME	1,237	20	1,458	491	3,018	46	3,053	4,356	–	–	1	299	13,979
Corporate – specialised lending	–	–	–	–	10	–	1	–	–	–	–	–	11
Central governments and central banks	–	–	–	–	–	–	–	15,714	–	–	–	–	15,714
Institutions	–	10	–	8	–	–	–	7,770	–	–	142	40	7,970
Retail IRB approach													
Retail mortgages	1,544	6	358	377	1,953	38	4,820	2,016	348,212	2	–	–	359,326
of which: residential mortgages (SME)	1,544	6	358	377	1,953	38	4,820	2,016	–	2	–	–	11,114
of which: residential mortgages (non-SME)	–	–	–	–	–	–	–	–	348,212	–	–	–	348,212
Qualifying revolving retail exposures	–	–	–	–	–	–	–	–	–	36,287	–	–	36,287
Other SME	227	3	208	313	638	17	416	910	–	4	–	–	2,736
Other non-SME	–	–	–	–	–	–	–	–	–	9,846	–	4,753	14,599
Other IRB approaches													
Corporate – specialised lending	2	902	333	591	1,574	8	14,793	3,604	–	–	613	–	22,420
Equities – exchange traded	–	–	–	–	–	–	–	682	–	–	–	–	682
Equities – private equity	–	92	333	150	420	597	390	1,032	–	–	–	–	3,014
Equities – other	–	–	–	–	–	–	–	54	–	–	–	–	54
Securitisation positions	–	–	–	–	–	–	–	14,351	–	–	–	–	14,351
Total – IRB approach	3,182	4,794	14,611	4,879	20,009	3,217	34,237	81,956	348,212	46,142	3,373	7,027	571,639
Exposures subject to the standardised approach													
Central governments and central banks	–	–	–	–	–	–	–	83,616	–	–	–	1	83,617
Regional governments or local authorities	–	–	–	–	–	–	–	–	–	–	–	–	–
Public sector entities	–	–	–	–	–	–	–	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–	–	–	–	–	–	–	–
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	–	–	159	41	–	5	–	205
Corporates	2,370	389	1,153	229	2,651	96	1,664	17,715	3	337	313	56	26,976
Retail	1,515	–	5	26	61	–	68	84	942	1,420	–	195	4,316
Secured by mortgages on immovable property	4	–	1	5	13	–	24	191	9,336	1	–	–	9,575
of which: residential property	4	–	1	5	13	–	24	179	9,336	1	–	–	9,563
of which: commercial property	–	–	–	–	–	–	–	12	–	–	–	–	12
Exposures in default	11	1	28	33	160	–	310	201	521	68	3	3	1,339
Exposures associated with particularly high risk	–	–	–	–	–	–	1	–	–	–	–	–	1
Covered bonds	–	–	–	–	–	–	–	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–	–	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–	–	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–	–	–	–	–	–	–	–
Total – standardised approach	3,900	390	1,187	293	2,885	96	2,067	101,975	10,843	1,826	321	255	126,038
Total	7,082	5,184	15,798	5,172	22,894	3,313	36,304	183,931	359,055	47,968	3,694	7,282	697,677
Other items													5,404
Non-credit obligation assets													8,441
Contributions to the default fund of a central counterparty													143
Total credit risk exposure													711,665

Appendix 2: Lloyds Bank Group continued

ANALYSIS OF CREDIT RISK EXPOSURES BY GEOGRAPHY

Credit risk exposures as at 31 December 2014, analysed by geographical region, based on the country of residence of the customer, are provided in the table below.

Table 107:
Lloyds Bank Group credit risk exposures analysed by geographical region

	2014 United Kingdom £m	2014 Rest of Europe £m	2014 United States of America £m	2014 Asia-Pacific £m	2014 Other £m	2014 Total £m
Exposures subject to the IRB approach						
Foundation IRB approach						
Corporate – main	60,028	9,359	8,620	690	1,799	80,496
Corporate – SME	13,912	27	–	22	18	13,979
Corporate – specialised lending	1	–	–	–	10	11
Central governments and central banks	–	2	15,629	–	83	15,714
Institutions	2,442	3,567	989	262	710	7,970
Retail IRB approach						
Residential mortgages	350,823	8,498	–	1	4	359,326
of which: residential mortgages (SME)	11,105	4	–	1	4	11,114
of which: residential mortgages (non-SME)	339,718	8,494	–	–	–	348,212
Qualifying revolving retail exposures	36,287	–	–	–	–	36,287
Other SME	2,735	–	–	–	1	2,736
Non-SME	14,519	80	–	–	–	14,599
Other IRB approaches						
Corporate – specialised lending	15,730	5,003	484	238	965	22,420
Equities – exchange traded	570	112	–	–	–	682
Equities – private equity	2,765	102	89	17	41	3,014
Equities – other	45	9	–	–	–	54
Securitisation positions	9,973	807	3,571	–	–	14,351
Total – IRB approach	509,830	27,566	29,382	1,230	3,631	571,639
Exposures subject to the standardised approach						
Central governments and central banks	76,458	6,925	211	14	9	83,617
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	50	71	58	26	–	205
Corporates	21,740	2,436	1,367	403	1,030	26,976
Retail	3,419	889	1	5	2	4,316
Secured by mortgages on immovable property	8,348	312	109	620	186	9,575
of which: residential mortgages (SME)	8,348	300	109	620	186	9,563
of which: residential mortgages (non-SME)	–	12	–	–	–	12
Exposures in default	894	366	21	24	34	1,339
Exposures associated with particularly high risk	1	–	–	–	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–
Total – standardised approach	110,919	10,999	1,767	1,092	1,261	126,038
Total	620,749	38,565	31,149	2,322	4,892	697,677
Other items						5,404
Non-credit obligation assets						8,441
Contributions to the default fund of a central counterparty						143
Total credit risk exposure						711,665

ANALYSIS OF CREDIT RISK EXPOSURES BY RESIDUAL MATURITY

Credit risk exposures as at 31 December 2014, analysed by residual contractual maturity, are provided in the table below.

Table 108:
Lloyds Bank Group credit risk exposures analysed by residual contractual maturity

	2014 On demand £m	2014 Repayable in 3 months or less £m	2014 Repayable between 3 months and 1 year £m	2014 Repayable between 1 and 5 years £m	2014 Repayable over 5 years or undated £m	2014 Total £m
Exposures subject to the IRB approach						
Foundation IRB approach						
Corporate – main	5,738	5,001	16,684	40,977	12,096	80,496
Corporate – SME	1,030	636	3,475	3,264	5,574	13,979
Corporate – specialised lending	10	–	–	–	1	11
Central governments and central banks	–	8,638	909	951	5,216	15,714
Institutions	243	725	1,950	3,200	1,852	7,970
Retail IRB approach						
Retail Mortgages	1,147	1,203	11,191	21,172	324,613	359,326
of which: residential mortgages (SME)	317	549	965	1,463	7,820	11,114
of which: residential mortgages (non-SME)	830	654	10,226	19,709	316,793	348,212
Qualifying revolving retail exposures	36,287	–	–	–	–	36,287
Other SME	142	352	759	378	1,105	2,736
Other non-SME	74	265	1,260	11,727	1,273	14,599
Other IRB approaches						
Corporate – specialised lending	361	1,177	2,091	10,098	8,693	22,420
Equities – exchange traded	–	–	–	–	682	682
Equities – private equity	–	112	398	2,167	337	3,014
Equities – other	–	–	2	7	45	54
Securitisation positions	–	1,019	8,007	1,609	3,716	14,351
Total – IRB approach	45,032	19,128	46,726	95,550	365,203	571,639
Exposures subject to the standardised approach						
Central governments and central banks	34,382	5,999	54	3,812	39,370	83,617
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	–	–	–	8	1	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	38	104	59	4	–	205
Corporates	1,190	375	1,627	3,962	19,822	26,976
Retail	1,055	24	97	703	2,437	4,316
Secured by mortgages on immovable property	680	44	129	835	7,887	9,575
of which: residential mortgages (SME)	680	44	129	823	7,887	9,563
of which: residential mortgages (non-SME)	–	–	–	12	–	12
Exposures in default	238	42	91	251	717	1,339
Exposures associated with particularly high risk	–	–	–	1	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–
Total – standardised approach	37,583	6,588	2,057	9,576	70,234	126,038
Total	82,615	25,716	48,783	105,126	435,437	697,677
Other items						5,404
Non-credit obligation assets						8,441
Contributions to the default fund of a central counterparty						143
Total credit risk exposure						711,665

Appendix 3: Bank of Scotland Group

OWN FUNDS DISCLOSURE TEMPLATE

Table 109:
Bank of Scotland Group own funds template

As at 31 December 2014	Transitional rules £m	Fully loaded rules £m
Common equity tier 1 (CET1) capital: instruments and reserves		
Capital instruments and related share premium accounts	5,847	5,847
of which: called up share capital	5,847	5,847
Retained earnings	12,493	12,493
Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	2,505	2,505
Foreseeable dividend	(5,000)	(5,000)
Common equity tier 1 (CET1) capital before regulatory adjustments	15,845	15,845
Common equity tier 1 (CET1) capital: regulatory adjustments		
Additional value adjustments	(123)	(123)
Intangible assets (net of related tax liability)	(423)	(423)
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)	(2,144)	(2,144)
Fair value reserves related to gains or losses on cash flow hedges	(484)	(484)
Negative amounts resulting from the calculation of expected loss amounts	(314)	(314)
Exposure amount of the following items which qualify for a risk weight of 1,250%, where the Group has opted for the deduction alternative	(181)	(181)
of which: securitisation positions	(181)	(181)
Regulatory adjustments relating to unrealised gains and losses pursuant to articles 467 and 468 of the CRR	(134)	–
of which: filter for unrealised gains	(134)	–
Total regulatory adjustments applied to common equity tier 1 (CET1)	(3,803)	(3,669)
Common equity tier 1 (CET1) capital	12,042	12,176
Additional Tier 1 (AT1) capital: instruments		
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	253	–
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	316	–
of which: instruments issued by subsidiaries subject to phase out	316	–
Additional tier 1 (AT1) capital	569	–
Tier 1 capital	12,611	12,176

As at 31 December 2014	Transitional rules £m	Fully loaded rules £m
Tier 2 (T2) capital: Instruments and provisions		
Capital instruments and related share premium accounts	5,546	5,546
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	1,230	–
Qualifying own funds instruments included in consolidated T2 caital (including minority interests and AT1 instruments not included in CET1 or AT1) issued by subsidiares and held by third parties	84	–
of which: instruments issued by subsidiaries to phase out	84	–
Credit risk adjustments	354	354
Tier 2 (T2) capital	7,214	5,900
Total Capital	19,825	18,076
Total risk weighted assets	90,550	90,550
Capital ratios and buffers		
Common Equity Tier 1 (as a percentage of risk exposure amount)	13.3%	13.4%
Tier 1 (as a percentage of risk exposure amount)	13.9%	13.4%
Total capital (as a percentage of risk exposure amount)	21.9%	20.0%
Common Equity Tier 1 available to meet buffers (as a percentage of risk exposures)[1]	9.3%	8.9%
Amounts below the threshold for deduction (before risk-weighting)		
Direct and indirect holdings of the capital of financial sector entities where the Group does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	49	49
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in 38 (3) of the CRR are met)	290	290
Applicable caps on the inclusion of provisions in Tier 2		
Cap on inclusion of credit risk adjustments in T2 under standardised approach	348	348
Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	475	475
Cap on inclusion of credit risk adjustments in T2 under internal ratings-based approach	354	354
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)		
Current cap on AT1 instruments subject to phase out arrangements	569	–
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	151	–
Current cap on T2 instruments subject to phase out arrangements	5,399	–

[1] Excluding CET1 required to meet Pillar 2A requirements under fully loaded.

Appendix 3: Bank of Scotland Group continued

OWN FUNDS RECONCILIATION

The following table presents, certain items that are used to calculate own funds, from the Bank of Scotland Group consolidated balance sheet on an accounting consolidation basis (as presented on pages 14 and 15 of the 2014 Bank of Scotland plc Annual Report and Accounts) which is the same as the Bank of Scotland Group consolidated balance sheet under the regulatory scope of consolidation for the year ended 31 December 2014. Where necessary, the balance sheet components under the regulatory scope of consolidation have been expanded such that the components of the transitional own funds disclosure template appear separately.

Table 110:
Bank of Scotland Group items extracted from the consolidated regulatory balance sheet

Balance Sheet Category	Items extracted from the consolidated regulatory balance sheet £m
Assets	
Goodwill	325
Other intangible assets	100
Total goodwill and other intangible assets	425
Deferred tax assets	2,432
Liabilities	
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	322
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	402
Preferred securities	724
Tier 2 capital instruments and related share premium accounts	4,562
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	168
Non eligible instruments	18
Undated subordinated liabilities	4,748
Tier 2 capital instruments and related share premium accounts	1,115
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	1,000
Non eligible instruments	40
Dated subordinated liabilities	2,155
Subordinated liabilities	7,627
Equity	
Share capital	5,847
Cash flow hedging reserve	484
AFS reserve	134
Other reserves	1,887
Other reserves	2,505
Retained profits	12,493
Shareholders' equity excluding non-controlling interests	20,845
Non-controlling interests	8
Total Equity	20,853

Table 111:
Bank of Scotland Group reconciliation of own funds items to audited financial statements

As at 31 December 2014	Items extracted from consolidated regulatory balance sheet £m	Own Funds £m	Difference	Note
Common Equity Tier 1 capital:				
Called up share capital	5,847	5,847	–	
Capital instruments and the related share premium accounts		5,847		
Retained earnings	12,493	12,493	–	
Accumulated other comprehensive income and other reserves (including unrealised gains or losses)	2,505	2,505	–	
Minority interests (amount allowed in consolidated CET1)	8	–	(8)	Note 1
Foreseeable dividend	–	(5,000)	(5,000)	Note 2
Common Equity Tier 1 (CET1) capital before regulatory adjustments		15,845		
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments		(123)	(123)	Note 3
Intangible assets (net of related tax liability), (negative amount)	(425)	(423)	2	Note 4
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) (negative amount)	(2,432)	(2,144)	288	Note 5
Fair value reserves related to gains or losses on cash flow hedges	(484)	(484)	–	
Negative amounts resulting from the calculation of expected loss amounts		(314)	(314)	Note 6
Exposure amount of the following items which qualify for a risk weight of 1250%, where the Group opts for the deduction alternative		(181)	(181)	Note 7
Regulatory adjustments relating to unrealised gains and losses pursuant to articles 467 and 468 of the CRR	(134)	(134)	–	
Total regulatory adjustments to Common Equity Tier 1 (CET1)		(3,803)		
Common Equity Tier 1 (CET1) capital		12,042		
Additional Tier 1 (AT1) capital: instruments				
Amount of qualifying items referred to in Article 484 (4) of the CRR and the related share premium accounts subject to phase out from AT1	322	253	(69)	Note 8
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by Lloyds Bank Group and held by third parties	402	316	(86)	Note 9
Additional Tier 1 (AT1) capital		569		
Tier 1 capital		12,611		
Tier 2 (T2) Capital: Instruments and Provisions				
Capital instruments and related share premium accounts	5,677	5,546	131	Note 10
Amount of qualifying items referred to in Article 484 (5) of the CRR and the related share premium accounts subject to phase out from T2	1,168	1,230	(62)	Note 11
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	–	84	84	Note 12
Credit risk adjustments	–	354	(354)	Note 13
Tier 2 (T2) capital		7,214		
Total capital		19,825		

Appendix 3: Bank of Scotland Group continued

[1] No eligible minority interests for regulatory purposes.

[2] The £5,000m foreseeable dividend is that recommended by the Board of Directors in respect of 2014 earnings.

[3] The additional value adjustments of £123m reflect the prudent valuation adjustment of all assets measured at fair value in accordance with Articles 34 and 105 of the CRR.

[4] The CRD IV rules require the amount deducted from own funds to be reduced by the amount of the associated deferred tax liabilities. A reconciliation from the gross amounts to the amount net of the associated deferred tax liability is presented in the table below.

	31 December 2014 £m
Goodwill as presented on the consolidated regulatory balance sheet, page 152	325
Intangible assets as presented on the consolidated regulatory balance sheet, page 152	100
Total goodwill and intangible assets as presented on the consolidated regulatory balance sheet, page 152	425
Deferred tax liability related to certain intangibles	(2)
Intangible assets (net of related tax liability) as presented in own funds	423

[5] The deferred tax assets as presented in the regulatory consolidated balance sheet represent all the Bank of Scotland Group deferred tax assets. The own funds deduction of £2,144m for deferred tax excludes the deferred tax balances for intangible assets. Additionally, only the deferred tax amounts that rely on future profitability are required to be deducted from CET1, and may be reduced by associated deferred tax liabilities where the conditions specified in Article 38 of the CRR are met. The deferred tax assets related to temporary differences form part of the Bank of Scotland Group gross drawn credit risk exposures.

[6] In accordance with Articles 36, 62, 158 and 159 of the CRR the excess of expected losses over specific credit risk adjustments (SCRAs) and additional value adjustments in relation to risk-weighted exposure amounts calculated using the Internal Ratings Based approach, of £314m, are deducted from CET1.

[7] The £181m deduction for securitisation positions reflects those positions that were rated below BB- or that are unrated.

[8] The £253m of AT1 instruments and the related share premium presented in own funds reflect instruments issued by Bank of Scotland Group that qualified as Tier 1 under the regulations that preceded CRD IV, subject to certain restrictions, including a cap set at 80% of the value of such instruments that were in issue at 31 December 2012 and net of interest. Any excess over the cap is included in Tier 2 capital, see note 11 below. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Preferred securities issued by the Bank of Scotland Group as presented on the consolidated regulatory balance sheet, page 152	322
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	(67)
Accrued interest and other adjustments	(2)
Qualifying items and related share premium accounts subject to phase out from AT1 as presented in own funds	253

[9] The £316m of AT1 instruments presented in own funds reflect instruments issued by subsidiaries and held by third parties that qualified at Tier 1 under the regulations that preceded CRD IV, subject to certain restrictions, including a cap set at 80% of the value of such instruments that were in issue at 31 December 2012 and net of interest. Any excess over the cap is included in Tier 2 capital, see note 12 below. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Preferred securities issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 152	402
Amount excluded from AT1 due to cap (excess over cap after redemption and maturities)	(84)
Accrued interest and other adjustments	(2)
Qualifying items issued by subsidiaries subject to phase out from AT1 presented in own funds	316

[10] The £5,546m of T2 instruments and the related share premium accounts presented in own funds reflect qualifying subordinated debt instruments issued by Bank of Scotland Group net of interest and amortisation. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Undated subordinated debt issued by the Bank of Scotland Group as presented on the consolidated regulatory balance sheet, page 152	4,562
Dated subordinated debt issued by the Bank of Scotland Group as presented on the consolidated regulatory balance sheet, page 152	1,115
Total undated and dated subordinated debt issued by the Bank of Scotland Group that are given recognition in T2	5,677
Accrued interest, amortisation and other adjustments	(131)
Capital instruments and related share premium accounts as presented in own funds	5,546

[11] The £1,230m of T2 instruments and the related share premium accounts presented in own funds reflect qualifying subordinated debt instruments issued by the Bank of Scotland Group net of interest. It includes any amounts in excess of AT1 caps that are given recognition in T2, as identified in note 8 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
Undated subordinated debt issued by the Bank of Scotland Group as presented on the consolidated regulatory balance sheet, page 152	168
Dated subordinated debt issued by the Bank of Scotland Group as presented on the consolidated regulatory balance sheet, page 152	1,000
Total undated and dated subordinated debt issued by the Bank of Scotland Group that are given recognition in T2	1,168
Instruments excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	67
Accrued interest and other adjustments	(5)
Qualifying items and related share premium accounts subject to phase out from T2 as presented in own funds	1,230

[12] The £84m of T2 instruments presented in own funds reflect qualifying subordinated debt instruments issued by subsidiaries and held by parties that were excluded from AT1 due to the cap that are given recognition in T2, as identified in note 9 above. A reconciliation of the qualifying instruments from the consolidated regulatory balance sheet to the amount recognised in own funds is presented in the table below.

	31 December 2014 £m
T2 instruments issued by subsidiaries as presented on the consolidated regulatory balance sheet, page 152	–
Instruments excluded from AT1 due to cap (excess over cap after redemptions and maturities) that are given recognition in T2	84
Qualifying items issued by subsidiaries as presented in own funds	84

[13] Credit risk adjustments of £354m reflect the surplus provisions resulting from the calculation of excess expected loss amounts in accordance with Articles 158 and 159 of the CRR, subject to certain limits.

CAPITAL REQUIREMENTS

BANK OF SCOTLAND 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 2014 are £90,550m (2013: £110,146m) and £7,244m (2013: £8,812m) respectively. Presented in the table below are the credit risk-weighted assets and associated Pillar 1 capital requirements.

Table 112:
Bank of Scotland Group capital requirements

	2014 Risk-weighted assets £m	2014 Pillar 1 capital requirements £m
CREDIT RISK		
Exposures subject to the IRB approach		
Foundation IRB approach		
Corporate – main	5,252	420
Corporate – SME	2,105	168
Corporate – specialised lending	3	–
Central governments and central banks	130	10
Institutions	335	27
Retail IRB approach		
Retail mortgages	31,006	2,480
of which: residential mortgages (SME)	–	–
of which: residential mortgages (non-SME)	31,006	2,480
Qualifying revolving retail exposures	6,967	557
Other SME	–	–
Other non-SME	3,403	272
Other IRB approaches		
Corporate – specialised lending	6,883	551
Equities – exchange traded	–	–
Equities – private equity	1,487	119
Equities – other	59	5
Securitisation positions	434	35
Non-credit obligation assets	1,076	86
Total – IRB approach	**59,140**	**4,730**

Appendix 3: Bank of Scotland Group continued

	2014 Risk-weighted assets £m	2014 Pillar 1 capital requirements £m
Exposures subject to the standardised approach		
Central governments and central banks	–	–
Regional governments or local authorities	–	–
Public sector entities	9	1
Multilateral development banks	–	–
International organisations	–	–
Institutions	20	2
Corporates	6,270	502
Retail	1,151	92
Secured by mortgages on immovable property	1,499	120
of which: residential property	1,488	119
of which: commercial property	11	1
Exposures in default	1,172	94
Exposures associated with particularly high risk	1	–
Covered bonds	–	–
Securitisation positions	–	–
Short-term claims on institutions and corporates	–	–
Collective investment undertakings (CIUs)	–	–
Equity exposures	–	–
Other items	2,000	160
Total – standardised approach	12,122	971
Contributions to the default fund of a central counterparty	1	–
Total credit risk	71,263	5,701
Threshold – significant investments	–	–
Threshold – deferred tax	725	58
Total credit risk	71,988	5,759

ANALYSIS OF CREDIT RISK MITIGATION

The following table provides an analysis of credit risk exposures covered by eligible financial collateral and other eligible collateral.

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.

Table 113:
Bank of Scotland Group eligible financial collateral and other eligible collateral

	2014 Exposures covered by eligible financial collateral £m	2014 Exposure covered by other eligible collateral £m	2014 Total £m
Exposures subject to the IRB Approach			
Foundation IRB Approach			
Corporate – main	5	3,508	3,513
Corporate – SME	29	2,112	2,141
Total – IRB Approach	34	5,620	5,654
Exposures subject to the Standardised Approach			
Corporates	500	–	500
Exposures in default	1	–	1
Total – Standardised Approach	501	–	501
Total	535	5,620	6,155

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.

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 2014, by major industrial sector, is provided in the table below.

Table 114:
Bank of Scotland Group past due but not impaired and impaired loans and advances analysed by major industrial sector

	Past due but not impaired		Impaired	
	2014 £m	2014 As a % of credit risk exposure	2014 £m	2014 As a % of credit risk exposure
Agriculture, forestry and fishing	15	2.37%	18	2.84%
Energy and water supply	4	0.90%	110	24.83%
Manufacturing	2	0.15%	124	9.23%
Construction	24	1.40%	255	14.91%
Transport, distribution and hotels	37	0.63%	1,245	21.09%
Postal and communications	2	5.71%	26	74.29%
Property companies	50	0.40%	3,071	24.44%
Financial, business and other services	36	0.05%	692	0.96%
Personal: Mortgages	8,479	3.26%	3,672	1.41%
Personal: Other	135	0.64%	618	2.91%
Lease financing	–	–	1	3.45%
Hire purchase	–	–	–	–
Total	8,784	2.30%	9,832	2.57%

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 2014, by geographical region, based on the country of residence of the customer, is provided in the table below.

Table 115:
Bank of Scotland Group past due but not impaired and impaired loans and advances analysed by geographical region

	Past due but not impaired		Impaired	
	2014 £m	2014 As a % of credit risk exposure	2014 £m	2014 As a % of credit risk exposure
United Kingdom	8,246	2.34%	6,438	1.83%
Rest of Europe	535	3.20%	3,250	19.43%
United States of America	–	–	82	1.57%
Asia-Pacific	2	1.42%	8	5.67%
Other	1	0.05%	54	2.90%
Total	8,784	2.30%	9,832	2.57%

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 2013 to 31 December 2014, in respect of loans and advances to customers is provided below.

Table 116:
Bank of Scotland Group movement in impairment provisions (loans and advances to customers)

	£m
At 31 December 2013	12,874
Exchange and other adjustments	(382)
Advances written off	(7,361)
Recoveries of advances written off in previous years	112
Unwinding of discount	(29)
Charge to the income statement	469
At 31 December 2014	**5,683**

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Appendix 3: Bank of Scotland Group continued

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.

Table 117:
Bank of Scotland Group impairment provisions and net charge analysed by major industrial sector

	2014 Impairment provisions £m	2014 Net charge £m
Agriculture, forestry and fishing	10	–
Energy and water supply	41	24
Manufacturing	97	(19)
Construction	107	(94)
Transport, distribution and hotels	810	163
Postal and communications	11	4
Property companies	2,219	(32)
Financial, business and other services	598	83
Personal: Mortgages	1,483	74
Personal: Other	306	269
Lease financing	1	(1)
Hire purchase	–	(2)
Total	**5,683**	**469**

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 118:
Bank of Scotland Group impairment provisions and net charges analysed by geographical region

	2014 Impairment provisions £m	2014 Net charge £m
United Kingdom	2,927	396
Rest of Europe	2,640	88
United States of America	41	(11)
Asia-Pacific	12	(1)
Other	63	(3)
Total	**5,683**	**469**

ANALYSIS OF CREDIT RISK EXPOSURES

Table 119:
Bank of Scotland Group credit risk exposures

Exposure Class	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2014 Average credit risk exposure £m
Exposures subject to the IRB approach				
Foundation IRB approach				
Corporate – main	8,535	5,252	62%	11,003
Corporate – SME	3,618	2,105	58%	4,515
Corporate – specialised lending	10	3	30%	10
Central governments and central banks	2,623	130	5%	3,110
Institutions	4,241	335	8%	3,182
Retail IRB approach				
Retail mortgages	254,088	31,006	12%	253,634
of which: residential mortgages (SME)	–	–	–	–
of which: residential mortgages (non-SME)	254,088	31,006	12%	253,634
Qualifying revolving retail exposures	17,589	6,967	40%	17,444
Other SME	–	–	–	–
Other non-SME	2,819	3,403	121%	2,765
Other IRB approaches				
Corporate – specialised lending	9,488	6,883	73%	14,879
Equities – exchange traded	–	–	–	–
Equities – private equity	782	1,487	190%	866
Equities – other	16	59	370%	61
Securitisation positions	4,419	434	10%	4,675
Non-credit obligation assets	3,383	1,076	32%	1,214
Total – IRB approach	311,611	59,140	19%	317,358
Exposures subject to the standardised approach				
Central governments and central banks	255	–	–	1,005
Regional governments or local authorities	–	–	–	7
Public sector entities	9	9	100%	10
Multilateral development banks	–	–	–	–
International organisations	–	–	–	–
Institutions	46,457	20	–	80,480
Corporates	13,999	6,270	45%	24,507
Retail	1,532	1,151	75%	1,809
Secured by mortgages on immovable property	4,263	1,499	35%	4,440
of which: residential property	4,251	1,488	35%	4,391
of which: commercial property	12	11	100%	49
Exposures in default	1,042	1,172	112%	1,772
Exposures associated with particularly high risk	1	1	150%	1
Covered bonds	–	–	–	–
Securitisation positions	–	–	–	–
Short term claims on institutions and corporates	–	–	–	259
Collective investment undertakings (CIUs)	–	–	–	–
Equity exposures	–	–	–	1
Other items	2,668	2,000	75%	4,701
Total – standardised approach	70,226	12,122	17%	118,992
Contributions to the default fund of a central counterparty	2	1	49%	1
Total credit risk	381,839	71,263	19%	436,351

Appendix 3: Bank of Scotland Group continued

Exposure Class	2014 Credit risk exposure £m	2014 Risk-weighted assets £m	2014 Average risk weight %	2014 Average credit risk exposure £m
Threshold – significant investments	–	–	–	–
Threshold – deferred tax	290	725	250%	398
Total credit risk	**382,129**	**71,988**	**19%**	**436,749**

ANALYSIS OF CREDIT RISK EXPOSURES BY INDUSTRY

Credit risk exposures as at 31 December 2014, analysed by major industrial sector, are provided in the table below.

Table 120:
Bank of Scotland Group credit risk exposure analysed by major industrial sector

	2014 Agriculture, forestry and fishing £m	2014 Energy and water supply £m	2014 Manufacturing £m	2014 Construction £m	2014 Transport, distribution and hotels £m	2014 Postal and comms £m	2014 Property companies £m	2014 Financial, business and other services £m	2014 Personal: mortgages £m	2014 Personal: other £m	2014 Lease Financing £m	2014 Hire Purchase £m	2014 Total £m
Exposures subject to the IRB approach													
Foundation IRB approach													
Corporate – main	4	117	807	1,066	2,069	13	2,569	1,887	–	3	–	–	8,535
Corporate – SME	25	5	188	181	958	11	1,564	686	–	–	–	–	3,618
Corporate – specialised lending	–	–	–	–	10	–	–	–	–	–	–	–	10
Central governments and central banks	–	–	–	–	–	–	–	2,623	–	–	–	–	2,623
Institutions	–	–	–	–	–	–	–	4,241	–	–	–	–	4,241
Retail IRB approach													
Retail mortgages	–	–	–	–	–	–	–	–	254,088	–	–	–	254,088
of which: residential mortgages (SME)	–	–	–	–	–	–	–	–	–	–	–	–	–
of which: residential mortgages (non-SME)	–	–	–	–	–	–	–	–	254,088	–	–	–	254,088
Qualifying revolving retail exposures	–	–	–	–	–	–	–	–	–	17,589	–	–	17,589
Other SME	–	–	–	–	–	–	–	–	–	–	–	–	–
Other non-SME	–	–	–	–	–	–	–	–	–	2,819	–	–	2,819
Other IRB approaches													
Corporate – specialised lending	1	308	101	288	761	3	6,713	1,313	–	–	–	–	9,488
Equities – exchange traded	–	–	–	–	–	–	–	–	–	–	–	–	–
Equities – private equity	–	–	–	–	34	–	383	365	–	–	–	–	782
Equities – other	–	–	–	–	–	–	–	16	–	–	–	–	16
Securitisation positions	–	–	–	–	–	–	–	4,419	–	–	–	–	4,419
Total – IRB approach	30	430	1,096	1,535	3,832	27	11,229	15,550	254,088	20,411	–	–	308,228
Exposures subject to the standardised approach													
Central governments and central banks	–	–	–	–	–	–	–	255	–	–	–	–	255
Regional governments or local authorities	–	–	–	–	–	–	–	–	–	–	–	–	–
Public sector entities	–	–	–	–	–	–	–	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–	–	–	–	–	–	–	–
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	–	–	46,416	41	–	–	–	46,457
Corporates	594	12	228	154	1,915	8	1,143	9,677	–	210	27	31	13,999
Retail	–	–	–	–	–	–	10	56	883	583	–	–	1,532
Secured by mortgages on immovable property	–	–	–	–	–	–	–	12	4,251	–	–	–	4,263
of which: residential property	–	–	–	–	–	–	–	–	4,251	–	–	–	4,251
of which: commercial property	–	–	–	–	–	–	–	12	–	–	–	–	12
Exposures in default	9	1	20	21	156	–	185	124	472	50	2	2	1,042
Exposures associated with particularly high risk	–	–	–	–	–	–	1	–	–	–	–	–	1
Covered bonds	–	–	–	–	–	–	–	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–	–	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–	–	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–	–	–	–	–	–	–	–
Total – standardised approach	603	13	248	175	2,071	8	1,339	56,549	5,647	843	29	33	67,558
Total	633	443	1,344	1,710	5,903	35	12,568	72,099	259,735	21,254	29	33	375,786
Other items													2,668
Non-credit obligation assets													3,383
Contributions to the default fund of a central counterparty													2
Total credit risk exposure													381,839

Appendix 3: Bank of Scotland Group continued

ANALYSIS OF CREDIT RISK EXPOSURES BY GEOGRAPHY

Credit risk exposures as at 31 December 2014, analysed by geographical region, based on the country of residence of the customer, are provided in the table below.

Table 121:
Bank of Scotland Group credit risk exposures analysed by geographical region

	2014 United Kingdom £m	2014 Rest of Europe £m	2014 United States of America £m	2014 Asia-Pacific £m	2014 Other £m	2014 Total £m
Exposures subject to the IRB approach						
Foundation IRB approach						
Corporate – main	7,246	143	850	18	278	8,535
Corporate – SME	3,567	17	–	22	12	3,618
Corporate – specialised lending	–	–	–	–	10	10
Central governments and central banks	–	–	2,623	–	–	2,623
Institutions	1,356	2,398	87	–	400	4,241
Retail IRB approach						
Retail mortgages	245,611	8,477	–	–	–	254,088
of which: residential mortgages (SME)	–	–	–	–	–	–
of which: residential mortgages (non-SME)	245,611	8,477	–	–	–	254,088
Qualifying revolving retail exposures	17,589	–	–	–	–	17,589
Other SME	–	–	–	–	–	–
Non-SME	2,819	–	–	–	–	2,819
Other IRB approaches						
Corporate – specialised lending	6,250	2,696	177	61	304	9,488
Equities – exchange traded	–	–	–	–	–	–
Equities – private equity	585	79	66	11	41	782
Equities – other	7	9	–	–	–	16
Securitisation positions	2,550	691	1,178	–	–	4,419
Total – IRB approach	287,580	14,510	4,981	112	1,045	308,228
Exposures subject to the standardised approach						
Central governments and central banks	70	185	–	–	–	255
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	9	–	–	–	–	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	46,386	71	–	–	–	46,457
Corporates	12,392	550	228	11	818	13,999
Retail	666	866	–	–	–	1,532
Secured by mortgages on immovable property	4,078	185	–	–	–	4,263
of which: residential mortgages (SME)	4,078	173	–	–	–	4,251
of which: residential mortgages (non-SME)	–	12	–	–	–	12
Exposures in default	660	356	7	18	1	1,042
Exposures associated with particularly high risk	1	–	–	–	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–
Equity exposures	–	–	–	–	-	–
Total – standardised approach	64,262	2,213	235	29	819	67,558
Total	351,842	16,723	5,216	141	1,864	375,786
Other items						2,668
Non-credit obligation assets						3,383
Contributions to the default fund of a central counterparty						2
Total credit risk exposure						381,839

ANALYSIS OF CREDIT RISK EXPOSURES BY RESIDUAL MATURITY

Credit risk exposures as at 31 December 2014, analysed by residual contractual maturity, are provided in the table below.

Table 122:
Bank of Scotland Group credit risk exposures analysed by residual contractual maturity

	2014 On demand £m	2014 Repayable in 3 months or less £m	2014 Repayable between 3 months and 1 year £m	2014 Repayable between 1 and 5 years £m	2014 Repayable over 5 years or undated £m	2014 Total £m
Exposures subject to the IRB approach						
Foundation IRB approach						
Corporate – main	192	676	1,872	3,226	2,569	8,535
Corporate – SME	19	297	494	1,341	1,467	3,618
Corporate – specialised lending	10	–	–	–	–	10
Central governments and central banks	–	2,567	–	–	56	2,623
Institutions	–	146	131	2,262	1,702	4,241
Retail IRB approach						
Retail mortgages	645	403	8,657	13,118	231,265	254,088
of which: residential mortgages (SME)	–	–	–	–	–	–
of which: residential mortgages (non-SME)	645	403	8,657	13,118	231,265	254,088
Qualifying revolving retail exposures	17,589	–	–	–	–	17,589
Other SME	–	–	–	–	–	–
Other non-SME	42	51	288	2,122	316	2,819
Other IRB approaches						
Corporate – specialised lending	40	457	812	4,265	3,914	9,488
Equities – exchange traded	–	–	–	–	–	–
Equities – private equity	–	–	63	383	336	782
Equities – other	–	–	2	7	7	16
Securitisation positions	–	156	2,780	779	704	4,419
Total – IRB approach	18,537	4,753	15,099	27,503	242,336	308,228
Exposures subject to the standardised approach						
Central governments and central banks	132	–	–	–	123	255
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	–	–	–	8	1	9
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	30	41	–	–	46,386	46,457
Corporates	22	183	914	978	11,902	13,999
Retail	166	12	47	221	1,086	1,532
Secured by mortgages on immovable property	120	29	72	405	3,637	4,263
of which: residential mortgages (SME)	120	29	72	393	3,637	4,251
of which: residential mortgages (non-SME)	–	–	–	12	–	12
Exposures in default	13	29	89	240	671	1,042
Exposures associated with particularly high risk	–	–	–	1	–	1
Covered bonds	–	–	–	–	–	–
Securitisation positions	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–
Collective investment undertakings (CIUs)	–	–	–	–	–	–
Equity exposures	–	–	–	–	–	–
Total – standardised approach	483	294	1,122	1,853	63,806	67,558
Total	19,020	5,047	16,221	29,356	306,142	375,786
Other items						2,668
Non-credit obligation assets						3,383
Contributions to the default fund of a central counterparty						2
Total credit risk exposure						381,839

Appendix 4: Asset encumbrance

Table 123:
Asset encumbrance

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Assets as at 31 December 2014				
Total assets	146,147		568,241	
Equity instruments	–	–	1,950	1,950
Debt securities[1]	23,121	23,121	57,692	57,692
Other assets[2]	123,026		508,599	

Encumbered assets/collateral received and associated liabilities

	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities as at 31 December 2014	134,953	150,534

[1]Includes debt securities accounted for as trading and other financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets.

[2]All remaining regulatory balance sheet assets.

In accordance with the threshold criteria under PRA supervisory statement SS11/14 (CRD IV: Compliance with the European Banking Authority's Guidelines on the disclosure of encumbered and unencumbered assets) the Group is not required to report on the fair value of encumbered and unencumbered collateral received.

Monitoring and measurement of asset encumbrance

The Board and Group Asset and Liability Committee monitor and manage total balance sheet encumbrance and readily realisable unencumbered assets via a number of risk appetite metrics. At 31 December 2014, the Group had £146,147m of encumbered and £568,241m of unencumbered on balance sheet assets as per PRA/EBA regulatory reporting requirements. These numbers may differ from the Group's disclosures in the 2014 Lloyds Banking Group plc Annual Report and Accounts, mainly due to scope and definitional differences with certain assets considered to be encumbered for this disclosure and treated as 'cannot be used' in the Annual Report and Accounts. The vast majority of assets encumbered are in the UK banking entities, with the Group primarily encumbering mortgages and term lending through issuance programmes (covered bonds and securitisation) and tradable securities through securities financing activity (repo and stock lending). Approximately half of the unencumbered assets are available to encumber and meet any future possible funding requirements. The encumbered assets/collateral received and associated liabilities section demonstrates that in some transactions (i.e. covered bonds and securitisations) the Group will encumber assets in excess of the matching liabilities to provide greater security for investors.

The Group provides collateralised security financing services to its clients, providing them with cash financing or specific securities. Collateralised security financing is also used to manage the Group's own short-term cash and collateral needs. For securities accepted as collateral the reverse repo, margin and bond borrowing mandate is credit rating driven with appropriate notional limits per rating, asset and individual bond concentration. All securities are investment grade. With regard to repo and stock lending agreements the Group only trades with regulated entities. Many factors are taken into consideration the main being, the credit worthiness of the counterparty, pricing transparency, underlying bond liquidity, central bank eligibility, credit rating, concentration and country risk. The vast majority of collateral the Group uses in repo/reverse repo and stock lending/stock borrowing transactions is investment grade government issued, primarily UK Government debt. The majority of repo/reverse repo and stock lending/stock borrowing transactions are short term, having a residual maturity of less than three months.

Abbreviations

Abbreviation	Brief description
A	
ABCP	Asset-backed commercial paper
ABS	Asset-backed security
AFS	Available-for-sale
AIRB	Advanced Internal ratings-based model
AMA	Advanced Measurement Approach
ARA	Annual Report and Accounts
AT1	Additional Tier 1 capital
B	
BCBS	Basel Committee on Banking Supervision
BIPRU	Prudential Sourcebook for Banks, Building Societies and Investment Firms
C	
CCB	Capital conservation buffer
CCF	Credit conversion factor
CCP	Central counterparty
CCR	Counterparty credit risk
CDO	Collateralised debt obligation
CDS	Credit default swap
CET1	Common equity tier 1 capital
CIU	Collective investment undertaking
CLO	Collateralised loan obligation
CMBS	Commercial mortgage-backed security
CP	Commercial paper
CPB	Capital planning buffer
CRA	Credit reference agencies
CRD IV	Capital Requirements Directive and Regulation
CRM	Credit Risk Mitigation
CSA	Credit Support Annex
CVA	Credit valuation adjustment
D	
DVA	Debit valuation adjustment
E	
EAD	Exposure at default
EBA	European Banking Authority
ECAI	External Credit Assessment Institutions
ECNs	Enhanced Capital Notes
EDTF	Enhanced Disclosure Task Force
EEL	Excess expected loss
EL	Expected loss
EU	European Union
F	
FCA	Financial Conduct Authority (UK)
FCCM	Financial collateral comprehensive method
FII	Financial Institutional Interconnectedness
FIRB	Foundation Internal ratings-based model
Fitch	Fitch Group
FPC	Financial Policy Committee (UK)
FSB	Financial Stability Board
G	
GENPRU	The PRA's rules, as set out in the General Prudential Sourcebook
GRC	Group Risk Committee
Group	Lloyds Banking Group together with its subsidiary undertakings
GSIB	Globally Systemically Important Bank
I	
IAA	Internal Assessment Approach
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment Process
ICG	Individual capital guidance
IFRS	International Financial Reporting Standards
IMM	Internal Model Method
IRB	Internal ratings-based approach
IRC	Incremental risk charge
IRR	Interest rate risk
ISDA	International Swaps and Derivatives Association
L	
LCR	Liquidity Coverage Ratio
LGD	Loss given default
LIBOR	London Interbank Offer Rate
LTIP	Long-Term Incentive Plan
LTV	Loan-to-Value
M	
Moody's	Moody's Investor Service
MTM	Mark-to-market
N	
NSFR	Net Stable Funding Ratio
O	
OTC	Over-the-counter
P	
PD	Probability of default
PFE	Potential future exposure
PFI	Private Finance Initiative
PIT	Point-in-time
PPI	Payment protection insurance product
PPP	Public-private partnership
PRA	Prudential Regulation Authority (UK)

Abbreviations continued

PRR	Position risk requirements
PVA	Prudent valuation adjustment
Q	
QRRE	Qualifying revolving retail exposure
R	
RBA	Ratings Based Approach
Retail IRB	Retail Internal Ratings Based approach
RMBS	Residential mortgage-backed security
RNIV	Risks not in VaR
RWA	Risk-weighted asset
S	
S&P	Standard and Poor's rating agency
SCRA	Specific credit risk adjustment
SEs	Structured entities
SFTs	Securities Financing Transactions
SME	Small and medium-sized enterprise
SRT	Significant Risk Transfer
SVaR	Stressed VaR
SWIP	Scottish Widows Investment Partnership
T	
TSA	The Standardised Approach
TTC	Through-the-cycle
T2 capital	Tier 2 capital
U	
UK	United Kingdom
US	United States of America
V	
VaR	Value at risk

Glossary

Additional Tier 1 Capital (AT1)	Additional tier 1 capital instruments are non-cumulative perpetual securities containing a specific provision to write down the security or convert it to equity should the CET1 ratio fall to a defined trigger limit. The Group's current AT1 securities contain a trigger limit of 7 per cent.
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 III	The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 that are being phased in, through CRD IV, from 1 January 2014.
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 on 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.
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 capital (CET1)	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.
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.

Glossary continued

CRD IV	On 27 June 2013, the European Commission published, through the Official Journal of the European Union, its legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), which together form the CRD IV package. Amendments published on 30 November 2013 were made to the Regulation. The package implements the Basel III reforms in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. CRD IV rules apply from 1 January 2014 onwards, with certain requirements set to be phased 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 Linked Note	A credit linked note is a type of credit derivative. It is an arrangement whereby 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.
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.
CVA capital charge	A capital charge for CVA is applied under CRD IV requirements. The charge is based on the mid-market valuation of the portfolio of transactions with a counterparty and reflects the current market value of the credit risk of the counterparty to the institution, but does not reflect the current market value of the credit risk of the institution to 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.
Default fund contributions (CCPs)	Contributions to the default fund of a central counterparty (CCP) are made by clearing members to protect the CCP and its members in the event that losses incurred by the CCP, following the default of a member, are greater than the other defences employed by the CCP.
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)	This is the amount of loss that can be expected by the Group calculated in accordance with PRA rules. In broad terms it is calculated by multiplying the Default Frequency by the **Loss Given Default** by the **Exposure at Default**.

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 per cent – 95 per cent 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.
Exposure	An asset, off-balance sheet item or position which carries a risk of financial loss.
Exposure at Default (EAD)	The amount (expected or actual) owed by a customer at the time of the customer's default.
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.
Financial Institutions Interconnectedness (FII)	Loans to other financial sector entities (FSEs) may require additional capital to be held through an adjustment to risk-weighted assets. In particular this additional capital applies to large FSEs and unregulated FSEs and is reflective of the additional risk created through the correlation of interbank lending.
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 (FIRB) Approach	Application of the Foundation Internal Ratings Based (FIRB) Approach allows internal estimates of PD to be used by the Group in determining credit risk capital requirements for wholesale portfolios. However, LGD and EAD 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 FIRB Approach cannot be applied to retail portfolios.
Guaranteed mortgages	Mortgages for which there is a guarantor to provide the lender a certain level of financial security in the event of default of the borrower.
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.
Impaired loans	Impaired loans are loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.
Impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of 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. IRR 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 IAA 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 CRD IV and PRA 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 master agreement (ISDA)	A standardised contract developed by the ISDA which is used as an umbrella contract for bilateral derivative contracts.

Glossary continued

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)	The estimated loss that will arise if a customer defaults. 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 derivatives (OTC)	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 III framework sets out the minimum regulatory capital requirements for credit, operational and market risks.
Pillar 2	The second pillar of the Basel III 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 III 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 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)	The likelihood that a customer will default on their obligation within the next year.
Qualifying Revolving Retail Exposure (QRRE)	Qualifying Revolving Retail Exposures 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 CRD IV requirements.
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.
SME Scalar	A reducing scalar is applied to the risk-weighted assets for eligible small and medium sized enterprises (SMEs). This is designed to minimise the impact of the overall increase in capital requirements through CRD IV on the SME sector. This requirement is due to be reviewed in 2016.
Sovereign exposures	Exposures to central governments and central government departments, central banks and entities owned or guaranteed by the aforementioned.
Specific credit risk adjustment (SCRAs)	Specific credit risk adjustments comprise of accounting impairment provisions and fair value adjustments that reflect losses exclusively related to credit risk. The criteria for recognition and applications under CRD IV are governed by the EBA Regulatory Technical Standard on the calculation of specific and general credit risk adjustments.
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.
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.

Glossary continued

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.
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 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.
Total Return Swap	A credit linked note is a type of credit derivative. It is an arrangement whereby 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.
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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