HELPING BRITAIN PROSPER

Lloyds Banking Group

Capital and Risk Management Pillar 3 Report 2017

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Forward looking statements

This document contains certain forward looking statements with respect to the business, strategy, plans and/or results of Lloyds Banking Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds Banking Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will 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, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; statements of plans, objectives or goals of Lloyds Banking Group or its management including in respect of statements about the future business and economic environments in the UK and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, instability as a result of the exit by the UK from the European Union (EU) and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; changes to regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; 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 extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed 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.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

Executive summary

COMMON EQUITY TIER 1 RATIO

2017 14.1% (13.9% pro forma[1])
2016 13.6% (13.0% pro forma[2])

1 Allowing for the announced share buyback.
2 Adjusted for MBNA.

COMMON EQUITY TIER 1 RATIO
The Group's common equity tier 1 ratio has strengthened during the year primarily reflecting strong underlying capital generation driven by underlying profits, a reduction in risk-weighted assets and the positive impact of market and other movements, offset by an increase in conduct provisions.

TOTAL CAPITAL RATIO

2017 21.2%
2016 21.4%

TOTAL CAPITAL RATIO
The reduction in the Group's transitional total capital ratio largely reflects the amortisation of dated tier 2 instruments and foreign exchange movements on tier 1 and tier 2 instruments, offset by the increase in common equity tier 1 capital and the reduction in risk-weighted assets.

UK LEVERAGE RATIO

2017 5.3% (5.4% pro forma[3])
2016 5.2% (5.3% pro forma[3])

3 Calculated in accordance with the UK leverage framework which requires qualifying central bank claims to be excluded from the leverage exposure measure.

UK LEVERAGE RATIO
The increase in the Group's UK leverage ratio largely reflects the increase in fully loaded tier 1 capital and the underlying reduction in balance sheet assets, net of qualifying central bank claims and deconsolidation adjustments.

The CRD IV Leverage ratio is 4.9% (2016: 4.9%).

RISK-WEIGHTED ASSETS

2017 £210.9bn
2016 £215.5bn

RISK-WEIGHTED ASSETS
The reduction in risk-weighted assets primarily reflects PRA approved model changes, continued active portfolio management, foreign exchange movements, disposals and capital efficient securitisation activity. This was partly offset by the impact of the acquisition of MBNA and targeted growth in key customer segments.

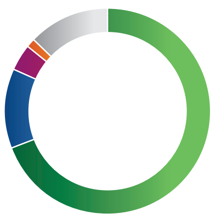
AVERAGE LIQUIDITY COVERAGE RATIO (WEIGHTED)

2017 125%

AVERAGE LIQUIDITY COVERAGE RATIO
The Group's liquidity surplus continues to exceed the regulatory minimum and internal risk appetite, with a weighted average liquidity coverage ratio of 125 per cent over the 12 months to 31 December 2017.

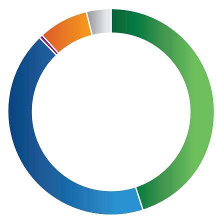
SPLIT OF RISK-WEIGHTED ASSETS

Risk-weighted assets by risk type[1]



Credit risk (IRB) £139.0bn	(2016: £147.7bn)
Credit risk (SA) £25.5bn	(2016: £19.0bn)
CCR[2] £7.9bn	(2016: £9.6bn)
Market risk £3.1bn	(2016: £3.1bn)
Operational risk £25.3bn	(2016: £25.3bn)

Risk-weighted assets by division[1]



Retail £90.8bn	(2016: £84.6bn)
Commercial Banking £85.6bn	(2016: £92.6bn)
Insurance and Wealth £1.3bn	(2016: £1.7bn)
Central Items £15.8bn	(2016: £17.3bn)
Run-off £7.3bn	(2016: £8.5bn)

1 Numbers do not include threshold risk-weighted assets.
2 Counterparty credit risk (CCR) includes contributions to the default fund of central counterparties and credit valuation adjustment risk.

Key metrics

The table below provides an overview of the Group's prudential regulatory metrics.

Table 1: Key Metrics (KM1)

	2017	Q3 2017	Q2 2017	Q1 2017	2016
Available capital (amounts)					
Common Equity Tier 1 (CET1) (£m)	**29,647**	30,519	29,320	30,588	29,284
Tier 1 (£m)	**36,329**	37,303	36,103	37,371	36,581
Total capital (£m)	**44,659**	46,010	45,203	46,763	46,123
Risk-weighted assets (amounts)					
Total risk-weighted assets (£m)	**210,919**	217,014	217,787	213,715	215,534
Risk-based capital ratios as a percentage of RWA					
Common Equity Tier 1 ratio (%)	**14.1%**	14.1%	13.5%	14.3%	13.6%
Tier 1 ratio (%)	**17.2%**	17.2%	16.6%	17.5%	17.0%
Total capital ratio (%)	**21.2%**	21.2%	20.8%	21.9%	21.4%
Additional CET1 buffer requirements as a percentage of RWA					
Capital conservation buffer requirement (2.5% from 2019)	**1.250%**	1.250%	1.250%	1.250%	0.625%
Countercyclical buffer requirement (%)	**0.002%**	0.002%	0.003%	0.003%	0.002%
Bank G-SIB and/or D-SIB additional requirements (%)	**–**	–	–	–	–
Total of bank CET1 specific buffer requirements (%)	**1.252%**	1.252%	1.253%	1.253%	0.627%
CET1 available after meeting the bank's minimum capital requirements (%)[1]	**9.6%**	9.6%	9.1%	9.8%	9.1%
UK leverage ratio[2]					
UK leverage ratio exposure measure (£m)	**657,234**	663,745	667,207	664,426	665,598
UK leverage ratio (%)	**5.3%**	5.4%	5.2%	5.4%	5.2%
Average Liquidity Coverage Ratio (weighted) (LCR)					
Total High Quality Liquid Assets (HQLA) (£m)	**124,543**	126,789	132,437	133,568	
Total net cash outflow (£m)	**99,703**	102,817	108,156	111,106	
LCR ratio (%)	**125%**	123%	123%	120%	

1 For this table, minimum capital requirements exclude CET1 required to meet Pillar 2A requirements. The Group's latest view on buffers under the UK capital framework is summarised on page 15.

2 The CRD IV Leverage ratio is 4.9% (2016: 4.9%). Further details can be found in Appendix 1 (Tables 83-85).

Introduction

This document presents the consolidated Pillar 3 disclosures of Lloyds Banking Group plc ('the Group') as at 31 December 2017.

Pillar 3 requirements are set out under the Capital Requirements Directive & Regulation (CRD IV) and are designed to promote market discipline through the disclosure of key information around capital, risk exposures and risk management. The Group's year end disclosures comply with the requirements of CRD IV and associated European Banking Authority (EBA) guidelines and technical standards in force as at 31 December 2017.

In satisfaction of certain disclosure requirements, reference has been made to the 2017 Lloyds Banking Group plc Annual Report and Accounts (ARA). As such, this document should be read in conjunction with the Annual Report and Accounts, as highlighted throughout the remainder of the document.

In 2015 the Basel Committee on Banking Supervision (BCBS) published revised Pillar 3 disclosure requirements as part of the first phase of revisions to the Basel Pillar 3 Framework with the aim of improving the comparability and consistency of disclosures between banks and within the various disclosures made by individual banks.

The EBA subsequently issued its guidelines on Pillar 3 disclosure requirements in December 2016 to ensure the harmonised and timely implementation of the Basel Pillar 3 Framework revisions within the European Union. These guidelines apply in full from 31 December 2017. For year-end 2016 the Group worked with other UK banks (via the UK Finance Pillar 3 working group) to adopt a forward-looking approach to the implementation of the guidelines and agreed with the Prudential Regulatory Authority (PRA) to early adopt a limited number of the EBA disclosure templates. The quantitative templates that were adopted included credit risk, counterparty credit risk and market risk type disclosures. The remaining quantitative templates that have been introduced for December 2017 mainly relate to the credit quality of assets and additional counterparty credit risk disclosures. A full listing of all EBA and BCBS adopted templates can be found in Appendix 4.

There are also a number of new EBA qualitative disclosure requirements that are either being met by existing disclosures in Pillar 3; within the risk management sections of the Annual Report and Accounts or through supplementary wording that has been inserted into the Pillar 3 report.

This year's disclosures have also been expanded to cover a wider scope of risks than the current Pillar 1 capital requirements and capital resources focus, as mandated by the BCBS who published final standards in March 2017 on disclosure requirements arising from the second phase of the revisions to the Basel Pillar 3 Framework. The Group has early adopted a number of templates, in particular, the report now includes quantitative and qualitative disclosures on liquidity requirements and prudent valuation adjustments (PVA). The new liquidity disclosures, which include publication of a weighted average Liquidity Coverage Ratio, are being driven by EBA guidelines published in March 2017 which the PRA requires UK banks to follow at December 2017. Qualitative disclosures on interest rate risk in the banking book (IRRBB) to meet the BCBS final standards have been included within the 2017 Lloyds Banking Group plc Annual Report and Accounts.

RISK STATEMENT

A statement from the Board is included within the Governance section of the 2017 Lloyds Banking Group plc Annual Report and Accounts (page 67) that describes the Group's risk management arrangements as being sufficiently adequate with regard to the Group's profile and strategy. 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.

The Chief Finance Officer (CFO) and the Chief Risk Officer (CRO) have also attested in writing that the 2017 Pillar 3 disclosures have been prepared in accordance with the internal control processes agreed upon at the Board level.

In addition, a risk statement approved by the management body is included within the Risk Overview section of the 2017 Lloyds Banking Group Annual Report and Accounts (pages 32 to 37).

PILLAR 3 REQUIREMENTS NOT INCLUDED IN EITHER THE ANNUAL REPORT AND ACCOUNTS OR THE PILLAR 3 REPORT

SIGNIFICANT SUBSIDIARY DISCLOSURES (CAPITAL REQUIREMENTS REGULATION (CRR) ARTICLE 13)

Additional disclosures surrounding the consolidated capital resources, leverage exposures and capital requirements of Lloyds Bank plc ('Lloyds Bank Group') and Bank of Scotland plc ('BOS Group') will be published separately in conjunction with the Annual Report and Accounts for these subsidiaries.

G-SIB DISCLOSURE (CRR ARTICLE 441(1))

The Group is not currently classified as a Global Systemically Important Bank (G-SIB), however, by virtue of its leverage exposure measure exceeding €200bn, the Group is required to report G-SIB indicator metrics to the PRA. The Group's indicator metrics used within the 2017 Basel G-SIBs annual exercise will be disclosed in April 2018, and the results are expected to be made available by the Basel Committee later this year.

CAPITAL INSTRUMENTS DISCLOSURE (CRR ARTICLE 437(1)(B))

A description of the main features of common equity tier 1 (CET1), additional tier 1 (AT1) and tier 2 (T2) 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/other-disclosures**

Disclosure policy

The Group maintains a Pillar 3 Disclosure Policy to support compliance with Articles 431-455 of the CRR and associated EBA guidelines and BCBS technical standards. The following sets out the key elements of the disclosure policy 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 2017, prepared in accordance with the requirements of CRR Part Eight (Disclosure by Institutions) and associated EBA guidelines and technical standards in force at December 2017. A CRR mapping table has been included in Appendix 5, which details how the Group has complied with each article under Part Eight.

The impact of IFRS 9 has not been applied in preparing the consolidated Pillar 3 disclosures as at 31 December 2017.

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, the definition of credit risk exposure and the recognition, classification and valuation of capital securities.

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

Pursuant to the disclosure requirements under the PRA's Group Financial Support Instrument, and in accordance with the general principles set out in Articles 431-434 of the CRR, Lloyds Banking Group has not entered into any group financial support agreement.

Article 432 of the CRR on non-material, proprietary or confidential information permits institutions to omit one or more disclosures if the information provided by such a disclosure is not regarded as material. As the Group's portfolio of trading book securitisation positions is relatively small (£289m exposure, £28m risk-weighted assets) in the context of both the overall trading book and the Group's banking book securitisation positions, the Group has elected to provide only limited disclosure around its trading book securitisation positions.

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

The minimum Pillar 1 capital requirements referred to in this document are calculated as 8 per cent of aggregated risk-weighted assets.

BASIS OF CREDIT RISK EXPOSURES

To ensure compliance with both CRR requirements and subsequent EBA guidelines, credit risk exposures are presented on different bases throughout the document. The table below provides a guide to the definitions applied to credit risk exposures in the Pillar 3 Credit risk section (pages 31 to 78).

Regulatory requirement	Credit risk exposure type	Pillar 3 tables/section
CRR Article 442	EAD pre CRM and post CCF (and post SCRAs for exposures risk-weighted under standardised approach)	Model performance section Total and average net amount of exposures (CRB-B) Divisional credit risk exposures Residential mortgage exposures by major portfolio Breakdown of exposures by geography/industry/maturity (CRB-C, D, E) Exposures subject to the IRB approach analysed by geographical region
	Gross carrying value (in line with accounting standards – IFRS)	Past due but not impaired loans and advances analysed by major industrial sector
Final EBA Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013	Gross and net (Gross exposures post SCRAs) exposures	Credit quality of exposures (CR1-A, B, C) CRM techniques – Overview (CR3)
	Two different bases: Gross carrying values (represented by the first two columns in the respective templates) and EAD pre CRM and post CCF	Credit risk exposures by portfolio and PD range (CR6)
	Two different bases: Net carrying values (Gross exposures net of SCRAs) and EAD pre CRM and post CCF	Standardised approach – credit risk exposure and Credit Risk Mitigation (CRM) effects (CR4) Equity exposures subject to the simple risk weight method (CR10) IRB Specialised lending (CR10)
	EAD post CRM and post CCF	Standardised approach – exposures by asset class (CR5)
	Gross carrying value (in line with accounting standards – IFRS)	Ageing of past-due exposures (CR1-D hybrid) Non-performing and forborne exposures (CR1-E)
CRR Article 447(b)	Gross carrying value (in line with accounting standards – IFRS)	Analysis of non-trading book exposures in equities

Counterparty credit risk exposures are presented on a post CRM basis, unless otherwise stated.

Securitisation positions represent 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.

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/other-disclosures).

The EBA guidelines on Pillar 3 disclosure frequency that were formally adopted by the Group from October 2015 define key information that institutions in the EU banking sector should consider disclosing on a more frequent than annual basis under Pillar 3. The Group's assessment of these guidelines has resulted in the disclosure of specific capital and leverage information at the interim quarter ends with further detailed analysis provided at half-year. The additional EBA guidelines issued in December 2016 (referred to in the Introduction) that apply in full from 31 December 2017 also define specific templates that banks are required to disclose on a quarterly and semi-annual basis. These templates relate mainly to credit risk, counterparty credit risk and market risk.

Disclosure policy continued

VERIFICATION

The disclosures presented within this document are not required to be subject 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 and Audit Committee following the receipt of attestations in respect of both the quantitative and qualitative disclosures from Finance and Risk Directors at Divisional and Group level.

RISK PROFILE DISCLOSURE

In accordance with the requirements of CRR Part Eight (Disclosure by Institutions), 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 2017 Lloyds Banking Group plc 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 Group's Pillar 3 disclosures focus primarily on capital risk and the key risk drivers behind the Group's Pillar 1 capital requirements (credit, counterparty credit, market and operational risks), providing granular information and analysis in addition to that presented within the 2017 Lloyds Banking Group plc Annual Report and Accounts.

The relevant analysis is presented in the following sections of the 2017 Lloyds Banking Group plc Annual Report and Accounts:

– Risk overview, pages 32 to 37;
– Emerging risks, page 110;
– Risk categories, page 115.

DIVISIONAL DISCLOSURES

Divisional exposures and risk-weighted assets have been restated to reflect the previously announced changes to the Group operating structure implemented in September 2017. The exposures and risk-weighted assets at Group level are unchanged as a result of these restatements. See Table 9 and Table 11 for further details.

Scope of consolidation

The following information 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, where these are classified as financial institutions. 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 below highlights the key insurance undertakings of the Group that are excluded from the scope of regulatory consolidation.

The full list of entities where the regulatory method of consolidation or treatment differs from the accounting method of consolidation or treatment is provided in Appendix 3, Table 88.

The capital requirements for the Insurance Group (under the Solvency II regime) and the capital available to meet them are regularly calculated in order to ensure that insurance businesses within the Group are sufficiently capitalised. The minimum required capital must be maintained at all times throughout the year.

Venture capital investments that are not classified as financial institutions and 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.

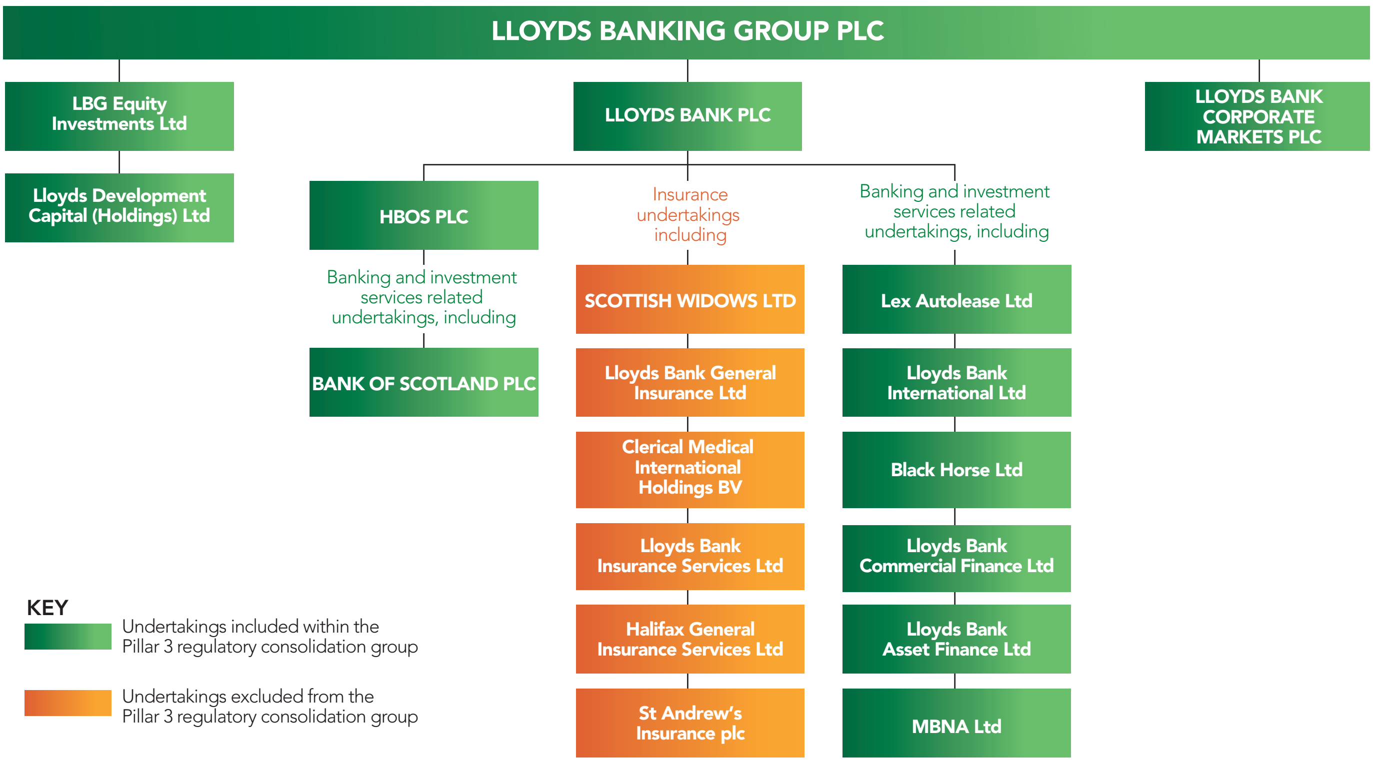
Management practice and policy ensures that capital adequacy is maintained at all levels of banking and insurance consolidation within the Group in accordance with the appropriate regulatory requirements.

The current legal and regulatory structure of the Group provides a capability for the prompt transfer of surplus capital resources over and above regulatory and internal risk appetite requirements or repayment of liabilities when due throughout the Group. There are currently no 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.

REGULATORY CONSOLIDATION GROUP

The key changes in the regulatory consolidation group in 2017 were the acquisition of MBNA Ltd along with internal structural changes to comply with ring-fencing legislation from 2019. These structural changes included the formation of LBG Equity Investments Ltd (to hold the Group's equity investments and investment vehicles) and Lloyds Bank Corporate Markets plc (LBCM), the non-ring-fenced bank.

A summarised diagrammatical representation (as at 31 December 2017) of the regulatory consolidation group upon which the disclosures presented within this document are based is provided below.



Scope of consolidation continued

CONSOLIDATED BALANCE SHEET UNDER THE REGULATORY SCOPE OF CONSOLIDATION

The following table provides a reconciliation of the Group's consolidated balance sheet as at 31 December 2017 on an accounting consolidation basis (as presented on pages 168 and 169 of the 2017 Lloyds Banking Group plc Annual Report and Accounts) to the Group's consolidated balance sheet under the regulatory scope of consolidation. It also breaks down how carrying values under the scope of regulatory consolidation are allocated to the different risk frameworks laid out in Part Three of the CRR.

Table 2: Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories (LI1)

	2017						
			Carrying values of items:				
	Carrying values as reported in published financial statements £m	Carrying values under regulatory scope of consolidation £m	subject to credit risk framework £m	subject to counterparty credit risk framework £m	subject to securitisation framework £m	subject to market risk framework £m	not subject to capital requirements or subject to deduction from capital £m
Assets							
Cash and balances at central banks	58,521	58,454	58,454	–	–	–	–
Items in the course of collection from banks	755	–	–	–	–	–	–
Trading and other financial assets at fair value through profit or loss	162,878	48,383	3,887	31,831	–	42,230	2,036
Derivative financial instruments	25,834	23,853	48	23,041	–	21,605	–
Loans & receivables:	482,752	471,719	434,437	21,156	15,550	–	578
Loans and advances to banks	6,611	4,350	1,963	2,387	–	–	–
Loans and advances to customers	472,498	463,182	428,974	18,768	15,440	–	–
Debt securities	3,643	4,187	3,499	–	110	–	578
Available-for-sale financial assets	42,098	44,149	42,098	–	2,051	–	–
Investment in group undertakings	–	8,004	3,455	–	–	–	4,549
Value of in-force business	4,839	–	–	–	–	–	–
Goodwill	2,310	488	–	–	–	–	488
Other intangible assets	2,835	2,666	–	–	–	–	2,666
Property, plant and equipment	12,727	9,073	9,073	–	–	–	–
Current tax recoverable	16	16	16	–	–	–	–
Deferred tax assets	2,284	3,110	678	–	–	–	2,432
Retirement benefit assets	723	723	–	–	–	–	723
Other assets	13,537	3,216	3,141	75	–	–	–
Total Assets	812,109	673,854	555,287	76,103	17,600	63,835	13,472

Scope of consolidation continued

	2017						
			Carrying values of items:				
	Carrying values as reported in published financial statements £m	Carrying values under regulatory scope of consolidation £m	subject to credit risk framework £m	subject to counterparty credit risk framework £m	subject to securitisation framework £m	subject to market risk framework £m	not subject to capital requirements or subject to deduction from capital £m
Liabilities							
Deposits from banks	29,804	–	–	–	–	–	–
Customer deposits	418,124	448,882	–	29,476	–	–	419,406
Items in course of transmission to banks	584	–	–	–	–	–	–
Trading and other financial liabilities at fair value through profit or loss	50,877	50,874	–	41,378	–	43,062	–
Derivative financial instruments	26,124	24,434	–	22,948	–	21,699	–
Notes in circulation	1,313	–	–	–	–	–	–
Debt securities in issue	72,450	70,336	–	–	–	–	70,336
Liabilities arising from insurance contracts and participating investment contracts	103,413	–	–	–	–	–	–
Liabilities arising from non-participating investment contracts	15,447	–	–	–	–	–	–
Other liabilities	20,730	6,948	–	–	–	–	6,948
Retirement benefit obligations	358	281	–	–	–	–	281
Current tax liabilities	274	119	–	–	–	–	119
Deferred tax liabilities	–	–	–	–	–	–	–
Other provisions	5,546	5,310	–	–	–	–	5,310
Subordinated liabilities	17,922	16,229	–	–	–	–	16,229
Total Liabilities	**762,966**	**623,413**	**–**	**93,802**	**–**	**64,761**	**518,629**

Differences between accounting and regulatory scopes of consolidation: Insurance undertakings are included in the published financial statements but excluded from the scope of the Group's regulatory consolidation. Therefore, assets and liabilities relating to the Group's insurance undertakings require to be removed from the regulatory balance sheet. The regulatory consolidation group diagram on page 7 highlights the key undertakings of the Group that are excluded from the scope of regulatory consolidation.

The table provides the breakdown of how the amounts reported in consolidated regulatory balance sheet correspond to regulatory risk framework categories. Certain items included in these columns are subject to more than one risk framework. As a consequence, the total reported in the 'Carrying Values under regulatory scope of consolidation' column may be lower than the sum of all the risk framework categories.

Market risk framework: Refer to Table 71: Market risk linkages to the balance sheet.

Not subject to capital requirements or subject to deduction from capital: Includes items which are not subject to capital requirements, as well as assets that are ultimately deducted from own funds and which are therefore not risk-weighted. See Table 81: Items extracted from the consolidated regulatory balance sheet and reconciliation of own funds items to audited financial statements.

Scope of consolidation continued

REGULATORY BALANCE SHEET ASSETS RECONCILIATION TO EXPOSURE AT DEFAULT (EAD)

A reconciliation of the consolidated regulatory balance sheet to exposure at default (EAD) for items subject to the credit risk, CCR and securitisation frameworks is presented below.

Table 3: Main sources of differences between regulatory exposure amounts and carrying values in financial statements (LI2)

	Items subject to:		
	Credit risk framework £m	CCR framework £m	Securitisation framework £m
Asset carrying value amount under scope of regulatory consolidation (as per template LI1)	555,287	76,103	17,600
Off balance sheet amounts	83,018	113,768	10,607
Differences due to specific regulatory adjustments	9,998	–	(2,051)
Differences due to consideration of provisions	2,940	–	–
Differences due to consideration of collateral, haircuts and netting	–	(162,182)	–
Net Potential Future Exposures	–	12,335	–
Exposure amounts considered for regulatory purposes	651,243	40,023	26,157

The carrying value of assets corresponds to the balances reported in Table 2.

Off balance sheet items are stated after the application of credit conversion factors (CCF). Under the credit risk framework, these balances principally consist of undrawn credit facilities. Under the counterparty credit risk framework, the off balance sheet items consist of the collateral given against cash received for securities financing transactions (SFT).

Differences due to specific regulatory adjustments primarily represent the uplift from gross exposure to modelled exposure at default for Retail IRB exposures.

Differences due to consideration of provisions relate to the grossing up of provisions related to IRB exposures.

Differences due to consideration of collateral, haircuts and netting consist of the regulatory calculation adjustments to arrive at the net exposure value.

Risk management

THE GROUP'S APPROACH TO RISK

The Group operates a prudent approach to risk with rigorous management controls to support sustainable business growth and minimise losses. Through a strong and independent risk function (Risk division) a robust control framework is maintained to identify and escalate current and emerging risks to support sustainable business growth within Group risk appetite and through good risk reward decision making.

Risk culture

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

As part of a conservative business model that embodies a risk culture founded on a prudent approach to managing risk, the Group reviewed its code of responsibility in 2017, reinforcing its approach under which colleagues are accountable for the risks they take and for prioritising their customers' needs.

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

Risk as a strategic differentiator

Group strategy and risk appetite are developed together to ensure one informs the other to deliver on our purpose to help Britain prosper whilst becoming the best bank for customers, colleagues and shareholders.

Risks are identified, managed and mitigated using our comprehensive Risk Management Framework and our well articulated risk appetite provides a clear framework for effective decision making. The principal risks we face, which could significantly impact the delivery of our strategy, are discussed in detail on pages 34 to 37 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

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

- **Prudent approach to risk:** Implementing a prudent approach to risk across the Group and embedding a strong risk culture ensures alignment to our strategy.
- **Strong control framework:** The Group's Risk Management Framework (RMF) is the foundation for the delivery of effective risk control and ensures that the Group risk appetite is continually developed and adhered to.
- **Business focus and accountability:** Effective risk management is a key focus and is included in key performance measures against which business units are assessed. Business units in the first line of defence are accountable for risk with oversight from a strong and independent, second line of defence Risk division.
- **Effective risk analysis, management and reporting:** Continuing to deliver regular close monitoring and stringent reporting to all levels of management and the Board ensures appetite limits are maintained and subject to stressed analysis at a risk type and portfolio level.
- **Sustainable growth:** Embedding a risk culture that ensures proactive support and constructive challenge takes place across the business is important for delivering sustainable growth.

Risk appetite

- Risk appetite is defined as the amount and type of risk that the Group is prepared to seek, accept or tolerate.
- Risk appetite is documented in a Group risk appetite statement which is reviewed by the Board Risk Committee and approved annually by the Board. The Group level metrics are supported by more detailed sub Board functional and divisional risk appetite metrics.
- As a key component of the Risk Management Framework, Group risk appetite is embedded within principles, policies, authorities and limits across the Group and continues to evolve to reflect external market developments and composition of the Group.
- The Group's strategy operates in tandem with the Group risk appetite and business planning is undertaken with a view to meeting the requirements of the Group risk appetite. Performance is optimised by allowing business units to operate within approved risk appetite and limits.
- The Board Risk Committee is responsible for overseeing the development, implementation and maintenance of the Group's overall Risk Management.
- Framework including its risk appetite, to ensure these are in line with emerging regulatory, corporate governance and industry best practice.

Governance and control

- The Group's approach to risk is founded on a robust control framework and a strong risk management culture which are the foundation for the delivery of effective risk management and guide the way all employees approach their work, behave and make decisions.
- Governance is maintained through delegation of authority from the Board down to individuals through the management hierarchy. Senior executives are supported by a committee based structure which is designed to ensure open challenge and support effective decision making.
- The Group's risk appetite, principles, policies, procedures, controls and reporting are regularly reviewed and updated where needed to ensure they remain fully in line with regulations, law, corporate governance and industry good-practice.
- 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.
- Board-level engagement, coupled with the direct involvement of senior management in Group-wide risk issues at Group Executive Committee level, ensures that escalated issues are promptly addressed and remediation plans are initiated where required.
- Line managers are directly accountable for identifying and managing risks in their individual businesses, ensuring that business decisions strike an appropriate balance between risk and reward and are consistent with the Group's risk appetite.
- Clear responsibilities and accountabilities for risk are defined across the Group through a three lines of defence model which ensures effective independent oversight and assurance in respect of key decisions.

Risk management continued

Risk decision making and reporting

- Taking risks which are well understood, consistent with strategy and with appropriate return 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 of the aggregate risk profile and has direct access to the Chairman and members of Board Risk Committee.

The most significant risks the Group faces which could impact delivery of its strategy together with key mitigating actions, in line with the Risk Management framework, are outlined in the Risk Overview section of the 2017 Lloyds Banking Group plc Annual Report and Accounts, pages 32 to 37.

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 2017 Lloyds Banking Group plc Annual Report and Accounts, page 111.

Further details on the Group's risk governance are presented in the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts, pages 113 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 2017 Lloyds Banking Group plc Annual Report and Accounts, as follows:

Conduct risk page 134; Funding and liquidity risk, pages 144 to 149; Capital risk, pages 137 to 144; Regulatory and legal risk, page 133; Insurance underwriting risk, page 137; People risk, page 136; Financial reporting risk, page 109; and Governance risk, page 150.

The regulatory capital framework

The Group's regulatory capital framework is defined by CRD IV, as implemented in the UK by the PRA and supplemented through additional regulation under the PRA Rulebook.

The framework consists of various classifications of capital resources – Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Tier 2 (T2) – to meet a stack of regulatory capital requirements and buffers, over and above which the Board maintains a management buffer to grow the business and cover uncertainties and future regulatory developments.

REGULATORY CAPITAL RESOURCES

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

Common equity tier 1 capital

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 equity investment in its Insurance business and a large part of the Group's deferred tax assets. Other significant deductions consist of the elimination of the cash flow hedging reserve and deductions applied for goodwill, other intangible assets and defined benefit pension surpluses.

Additional tier 1 capital

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 be partially 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 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.

CET1 and AT1 together form Tier 1 Capital (T1).

Tier 2 capital

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

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 subject to a percentage cap based on IRB risk-weighted assets; and a deduction is made for part of the subordinated debt issued by the Group's Insurance business that is not deducted from AT1 capital.

T1 and T2 together form Total Capital.

REGULATORY CAPITAL REQUIREMENTS AND BUFFERS

Prudential requirements under the Basel framework are categorised under three pillars: Pillar 1 – Minimum Capital Requirements; Pillar 2 – Supervisory Review Process; and Pillar 3 – Market Discipline.

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.

The minimum amount of total capital, under Pillar 1 of the regulatory framework, is determined as 8 per cent of aggregate risk-weighted assets. At least 4.5 per cent of risk-weighted assets are required to be covered by CET1 capital and at least 6 per cent of risk-weighted assets are required to be covered by tier 1 capital. These minimum Pillar 1 requirements are supplemented by additional minimum requirements under Pillar 2A of the regulatory framework and a number of regulatory capital buffers as described on pages 15 and 16.

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 under Pillar 1. 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 approval from the PRA. A brief summary of the different approaches for the different risk types and their application by the Group is disclosed on pages 14 and 15, with further detail provided in each of the sections as indicated.

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, utilising the following two key approaches:	
	Standardised Approach This is the most basic approach which relies on the application of a prescribed 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 and specific credit risk adjustments 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. Under this approach banks can utilise risk assessments from External Credit Assessment Institutions (ECAIs) for a number of exposure classes that cover rated counterparties, including corporates, central governments or central banks and institutions (refer to page 65 for further information on the application of ECAI).	The Group applies the Standardised Approach to the MBNA credit card portfolio and a small number of other portfolios across the Group. These portfolios are either awaiting roll-out under the Group's IRB roll-out plan (including the MBNA credit card portfolio) or are permanently exempt from the IRB Approach, including the majority of the Group's central government or central bank exposures. Little movement in the roll-out position is expected in 2018, with MBNA assets expected to move to IRB in 2019, subject to regulatory approval.
	IRB Approach (IRB) There are two main approaches for commercial exposures – Foundation IRB (FIRB) and Advanced IRB (AIRB). For retail exposures, Retail IRB (RIRB) is available. A prescribed regulatory formula is used to calculate risk-weighted assets which incorporates probability of default (PD), loss given default (LGD) and EAD in addition to other variables such as maturity and correlation.	
	Regulatory expected losses (EL) under the FIRB, AIRB and RIRB approaches are calculated by multiplying regulatory EAD by PD and LGD, which are determined for each of the above IRB approaches with the exception of defaulted exposures on the AIRB where the best estimate of expected loss (BEEL) is used. Under CRD IV there are also scaling factors 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.	Information on comparison of EL and SCRAs, which form the calculation of Excess EL can be found on page 77.
	Foundation IRB Approach The FIRB Approach uses internal assessments of a counterparty's PD (subject to certain floors) together with regulatory defined assessments for LGD and EAD.	The FIRB Approach is used for the majority of the Group's commercial exposures as the Group does not have permission to utilise the AIRB Approach for these portfolios.
	Advanced IRB Approach The AIRB Approach uses internal assessments of PD, EAD and LGD (subject to certain floors). *Retail IRB Approach* The Retail IRB Approach is a version of the AIRB Approach tailored to retail exposures.	The Group has permission to utilise the AIRB Approach for retail portfolios only and it applies the Retail IRB Approach (a version of the AIRB Approach) for its modelled retail exposures. For more information on IRB models refer to the Model Performance section on pages 37 to 48.
	Other IRB Approaches For certain specialised lending exposures there is also a Supervisory Slotting Approach which assigns regulatory prescribed risk weights to assets based on the characteristics of each exposure. For more detail on the application of the Supervisory slotting approach refer to page 62. A number of alternative methodologies currently exist for other areas such as equity exposures and securitisation positions. For exposures on the Supervisory Slotting Approach and Equity Simple Risk Weight method, regulatory expected losses are determined by applying prescribed percentages from the regulator.	The Group applies the Supervisory Slotting Approach to certain corporate specialised lending exposures comprising mainly its commercial real estate portfolios. 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), Supervisory Formula Approach (SFA) and Standardised Approach.
Counterparty credit risk	There are several approaches for measuring exposures to counterparty credit risk, as set out below. The resultant exposures are risk-weighted under either the Standardised Approach or the relevant IRB Approach, as appropriate, to determine the capital requirement. **Standardised Approach** The exposure value is calculated by applying a multiplier to the market value, dependent on the type of contract. **Original Exposure Method** Under this method the exposure value is calculated by multiplying the notional amount of the instrument by set percentages prescribed depending on maturity. **Mark-to-Market Method** Under this method an add-on for potential future exposure (PFE) is applied to the mark-to-market value of the instrument to give the overall exposure.	The Group's derivative and SFT counterparty credit risk exposures are respectively measured under the Mark-to-Market Method and SFT Comprehensive Approach, prior to being risk weighted under the Standardised Approach, FIRB Approach or Supervisory Slotting Approach as appropriate.

The regulatory capital framework continued

Risk type	Approaches	Application within the Group
Counterparty credit risk (continued)	**SFT Comprehensive Approach** Under this method volatility adjustments are applied to the market value of collateral to take account of price volatility. **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. Exposures to central counterparties (CCPs), comprising trades, default fund contributions and initial margin are subject to specific measurement and risk weight requirements. Credit valuation adjustment (CVA) risk is calculated under either the Advanced Method (via the use of internal models) or the Standardised Method.	The Group applies the Standardised Approach for calculating CVA risk.
Market risk	The two key approaches for Market Risk are as follows: **Standardised Approach (SA)** 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 (IMA)** Following PRA approval, involves the use of internal Value at Risk (VaR) and other 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 three 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 Measurement Approach (AMA)** A high risk sensitivity approach where, following PRA approval, the capital requirement is determined through the use of an internal operational risk measurement model.	The Group currently measures its operational risk requirement using the Standardised Approach.

PILLAR 2 – SUPERVISORY REVIEW PROCESS

The Pillar 1 minimum requirement for capital is supplemented by Pillar 2A firm specific Individual Capital Guidance (ICG) and a framework of regulatory capital buffers.

From 1 January 2018, Pillar 2A will be set as a firm specific capital requirement (Pillar 2R) rather than as individual capital guidance. The aggregate of the Pillar 1 and Pillar 2A capital requirements will be referred to as the Total Capital Requirement (TCR) of the firm.

INDIVIDUAL CAPITAL GUIDANCE

Under Pillar 2A, additional minimum requirements are currently set by the PRA through the issuance of bank specific ICG. This reflects a point-in-time estimate by the PRA, which may change over time, of the minimum amount of capital that is needed by the bank to cover risks that are not fully covered by Pillar 1, such as credit concentration and operational risk, and those risks not covered at all by Pillar 1, such as pensions and interest rate risk in the banking book.

During 2017 the Group's ICG was increased from 4.5 per cent to 5.4 per cent of risk-weighted assets of which 56 per cent (c.3 per cent of risk-weighted assets) has to be met by CET1 capital. The Group is not permitted by the PRA to disclose any details on the individual components of Pillar 2A.

A key input into the PRA's ICG setting process is a bank's own assessment of the amount of capital it needs, a process known as the Internal Capital Adequacy Assessment Process (ICAAP). The Group's 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. The operational risk includes consideration of conduct risk.

Risks not covered at all by Pillar 1

- Pension obligation risk – the potential for losses 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 changes in spreads between different rates.

The detailed ICAAP document is subject to a robust review process, approved by the Board and submitted to the PRA for consideration by the PRA ahead of setting ICG. In the future the ICAAP will include an assessment of Ring Fenced Bank group risk.

REGULATORY CAPITAL BUFFERS

The Group is also required to maintain a number of regulatory capital buffers, which are required to be met with CET1 capital.

Systemic buffers

Systemic buffers are designed to hold systemically important banks to higher capital standards, so that they can withstand a greater level of stress before requiring resolution.

- Although the Group is not currently classified as a global systemically important institution (G-SII) under the Capital Requirements Directive, it has been classified as an 'other' systemically important institution (O-SII) by the PRA. The O-SII buffer is set to zero in the UK.

The regulatory capital framework continued

– The Systemic Risk Buffer (SRB) will be applied to UK ring-fenced banks from 2019. The size of buffer applied to the Group's ring-fenced bank (RFB) sub-group in 2019 will be dependent upon the total assets of the sub-group. The FPC anticipates applying a buffer of 2.5 per cent to the largest ring-fenced institutions. Although the SRB will apply at a sub consolidated level within the Group's structure, the PRA have indicated that they will include in the Group's PRA Buffer an amount equivalent to the RFB's Systemic Risk Buffer. The amount included in the PRA Buffer is expected to be lower as a percentage of Group risk-weighted assets reflecting the assets of the Group that will not be held in the RFB sub-group and to which the SRB will not apply to.

Capital conservation buffer

The capital conservation buffer (CCB) is a standard buffer of 2.5 per cent of risk-weighted assets designed to provide for losses in the event of stress and is being phased in from 1 January 2016 to 1 January 2019. During 2017 it was 1.25 per cent and during 2018 it will increase to 1.875 per cent.

Countercyclical capital buffer

The countercyclical capital buffer (CCYB) 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 amount of the buffer is determined by reference to buffer rates set by the FPC for the individual countries where the Group has relevant credit risk exposures.

The CCYB rate for the UK is currently set at zero but will increase to 0.5 per cent on 27 June 2018 and to 1.0 per cent on 28 November 2018.

The FPC will reconsider the adequacy of a 1.0 per cent UK CCYB rate during the first half of 2018 in light of the evolution of the overall risk environment.

Non-zero buffer rates currently apply for Norway, Sweden, Hong Kong, Iceland, Slovakia and the Czech Republic. Given that the Group has minimal exposures to these jurisdictions, the overall countercyclical capital buffer requirement at 31 December 2017 of £5.2m (2016: £5.0m) is considered to be negligible.

Additional disclosures around the geographical distribution of credit exposures relevant to the calculation of the countercyclical capital buffer have been included in Appendix 1.

Sectoral capital requirements

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.

PRA buffer

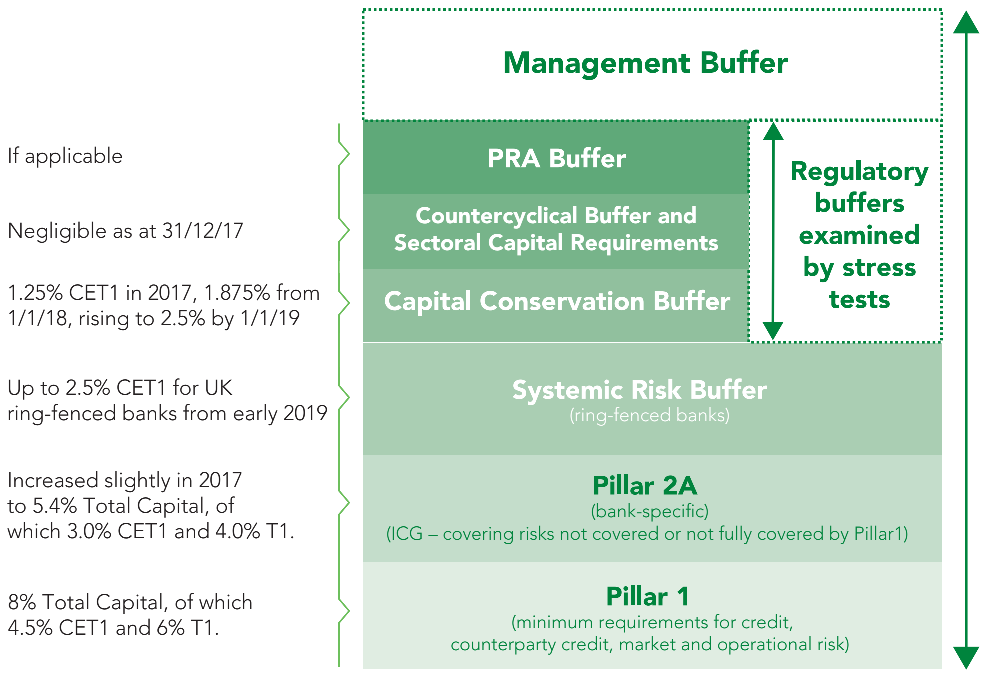
As part of the capital planning process, forecast capital positions are subjected to extensive stress analyses to determine the adequacy of the Group's capital resources against the minimum requirements, including ICG. The PRA uses the outputs from some of these stress analyses as one of the inputs that inform the setting of a bank-specific capital buffer for the Group, known as the PRA Buffer. The PRA Buffer also takes into account the CCB, CCYB and any sectoral capital requirements that already apply to the Group. The PRA requires the PRA Buffer to remain confidential between the Group and the PRA.

Further details on the Group's stress testing processes and the 2017 PRA stress testing results are included on page 143 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

All buffers

All buffers are required to be met with CET1 capital. Use of the PRA buffer would trigger a dialogue between the Group and the PRA to agree what action is required whereas use of the CRD IV combined buffer (all regulatory buffers excluding the PRA buffer) would also give rise to mandatory restrictions on discretionary capital distributions.

The following diagram summarises the capital framework requirements across the various tiers of capital and the Group's latest view on the amount of capital to be held. Percentages referenced below are against risk-weighted assets.



As reported in the Q3 Interim Management Statement, the Group's Pillar 2A CET1 requirement has increased by 0.5 per cent to 3 per cent. In addition, the Countercyclical Capital Buffer on UK exposures will be introduced during 2018 and the Systemic Risk Buffer will come into effect in early 2019. The Group is also pleased to announce that the PRA has now completed its annual review of the Group's PRA Buffer requirement.

The Board's view of the current level of CET1 capital required is c. 13 per cent, plus a management buffer of around 1 per cent.

The regulatory capital framework continued

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 risk exposures.

Minimum disclosure requirements are set out under the relevant CRR provisions (Part Eight – Disclosure by institutions), with further guidance and additional requirements set by the EBA. This includes the implementation of revisions to the Pillar 3 framework, designed to enhance consistency and comparability, which were first published by the Basel Committee in 2015.

LEVERAGE FRAMEWORK

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

The minimum leverage ratio requirement under the UK Leverage Ratio Framework is 3.25 per cent. In addition the framework requires two buffers to be maintained: an Additional Leverage Ratio Buffer (ALRB), which is calculated as 35 per cent of the Systemic Risk Buffer (applicable from 2019) and a time-varying Countercyclical Leverage Buffer (CCLB) which is calculated as 35 per cent of the countercyclical capital buffer rate (currently set at zero per cent). At least 75 per cent of the minimum 3.25 per cent requirement and the entirety of any buffers that may apply must be met by CET1 capital.

The calculation of the leverage ratio under the UK Leverage Ratio Framework differs from CRD IV requirements in that it excludes qualifying central bank claims from the leverage exposure measure.

The Group is required to continue to calculate and disclose a leverage ratio on a CRD IV basis, alongside the UK ratio.

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

RING-FENCING

The Group is making good progress with the implementation of its ring-fencing programme, including the establishment of the non ring-fenced bank, Lloyds Bank Corporate Markets plc (LBCM), and remains on track to meet the legal and regulatory requirements by 1 January 2019. As a predominantly UK retail and commercial bank, the impact on the Group is relatively limited, with minimal impact for the majority of the Group's retail and commercial customers.

Over the course of 2018, in order to comply with the ring-fencing legislation, certain businesses will be transferred out of Lloyds Bank plc and its subsidiaries to other parts of the Group, by means of statutory or contractual transfers. This will include the transfer of certain wholesale and international businesses to LBCM and the transfer of Scottish Widows Group and other insurance subsidiaries to Lloyds Banking Group plc.

Due to the Group's UK retail and commercial focus, the vast majority of the Group's business will continue to be held by Lloyds Bank plc and its subsidiaries (together the ring-fenced bank) these transfers will not have a material impact on the financial strength of Lloyds Bank plc.

IFRS 9 TRANSITIONAL ARRANGEMENTS

The European Parliament and Council published final rules in December 2017 on IFRS 9 transitional arrangements for capital. The arrangements, to be implemented from 1 January 2018 in line with the implementation of IFRS 9, will allow the initial net impact on CET 1 capital resulting from the increase in accounting impairment provisions under the new IFRS 9 Expected Credit Loss (ECL) framework, plus the capital impact of any subsequent increases in Stage 1 and Stage 2 ECLs (net of movements in regulatory expected losses), to be phased in over a five year transition period.

The phase in factors will allow 95 per cent of the resultant 'transitional adjustment' to be added back to CET1 capital in 2018, reducing down to 85 per cent in 2019, 70 per cent in 2020, 50 per cent in 2021 and 25 per cent in 2022, with full recognition of the impact of IFRS 9 ECLs on CET 1 capital from 2023.

The effect of adding back the transitional adjustment to CET1 capital will result in further consequential adjustments to T2 capital (eligible provisions) and risk-weighted assets.

FUTURE REGULATORY DEVELOPMENTS

Introduction

The Group's 2017 year end disclosures comply with all relevant CRD IV requirements and associated EBA guidelines and technical standards in force at 31 December 2017 as referenced in Appendices 4 and 5. It is important to note that specific aspects of the CRD IV text remain dependent upon the issuance of final EBA technical standards and guidelines as well as PRA policy and standards in relation to areas of national discretion.

The Group continues to closely monitor regulatory developments at global, European and UK levels in order to best position the Group to adapt to any changes arising.

Some of the key areas of development are discussed in the sections noted below:

- **Final Basel III reforms** will be subject to interpretation and implementation through European and UK legislation over the course of the next few years.
- **Draft EU Risk Reduction Package** which comprises extensive revisions to the existing CRD IV legislation.
- **Other risk framework developments** which include a combination of ongoing consultations, EBA recommendations and final rules.

Disclosure requirements

In March 2017 the Basel Committee on Banking Supervision published its second phase of revisions to the Pillar 3 framework. The majority of the revisions are intended to be implemented in full by the end of 2019. The third phase of its review of the framework will cover disclosure requirements arising from the final Basel III reforms and asset encumbrance. The Basel Committee is expected to publish its final review during 2018.

Final Basel III reforms

The Basel Committee published its final reforms of the Basel III Framework in December 2017. The purpose of the reforms is to restore credibility in the calculation of risk-weighted assets and to improve comparability between banks' capital ratios through the following measures:

- improving the granularity and risk sensitivity of the **standardised credit risk framework;**
- addressing shortcomings related to the use of the **IRB credit risk framework**, including excessive complexity, lack of comparability and lack of robustness in modelling certain asset classes, by removing the option to apply the Advanced IRB Approach for low default portfolios (banks, other financial institutions and large and mid-sized corporates), adopting input floors for PDs, LGDs and EADs to ensure a degree of conservatism is maintained in modelled outputs and providing greater specification of parameter estimation practices to reduce variability in risk-weighted assets.
- replacing the existing approaches under the **operational risk framework** with a single risk-sensitive standardised approach (the Standardised Measurement Approach) that combines a measure of a bank's income with a measure of its historic operational risk losses.
- revisions to the **credit valuation adjustment (CVA) risk framework** designed to enhance its risk sensitivity, strengthen its robustness and improve its consistency.
- replacing the current Basel II **capital floors (output)** requirement with a new version based on the revised Basel III standardised approaches.

The purpose of the new capital floors requirement is to act as a backstop that limits the extent to which banks can reduce their risk-weighted assets under modelled approaches relative to the standardised equivalents. The risk-weighted assets for a bank applying modelled approaches will therefore require to be the higher of (i) the total risk-weighted assets as calculated under the approaches applied by the bank and (ii) 72.5 per cent of the total risk-weighted assets calculated when applying standardised approaches only across all relevant risk categories.

The regulatory capital framework continued

The final reforms also include revisions to the **Basel III leverage ratio framework**, introducing a leverage buffer requirement for G-SIBs and refining the definition of the leverage ratio exposure measure. The latter includes the ability for local regulators to exempt central bank reserves from the exposure measure on a temporary basis during periods of exceptional macroeconomic circumstances, subject to a recalibration of the minimum leverage ratio requirement to compensate for the impact of excluding the associated balances. A similar regime already exists under the UK Leverage Ratio Framework.

The Basel Committee has proposed that the final reforms to the Basel III Framework should be implemented by 1 January 2022, with the exception of the capital floors (output) requirement which will be phased in over a five year period, commencing 1 January 2022 with a 50 per cent floor and thereafter building towards the full floor of 72.5 per cent by 1 January 2027.

The revised **market risk framework** that was finalised by the Basel Committee in January 2016 is now to be implemented by 1 January 2022 in line with the other reforms. It is being considered as part of the EU Risk Reduction Package.

EU Risk Reduction Package

In November 2016, the European Commission published a substantial package of draft reforms aimed at further strengthening the resilience of banks across the EU. This package comprises draft legislative texts updating the Capital Requirements Directive and Regulation (CRD IV) to include, amongst other reforms, the implementation of various Basel III Framework revisions, including market risk, standardised counterparty credit risk (SA-CCR), leverage, the net stable funding ratio (NSFR) and Pillar 3 as further detailed below. These reforms are currently under negotiation, with the latest draft amendments and compromise texts published in November 2017.

- **Market risk** – The Basel Committee issued its final standards on the Fundamental Review of the Trading Book (FRTB) in January 2016. The standard includes a move away from VaR based metrics under the internal models approach to a new expected shortfall measure of risk under stress, a revised Standardised approach for calculating market risk capital to a more risk-sensitive approach, incorporation of the risk of market illiquidity and a revised boundary between the banking book and the trading book. The new framework is now expected to be implemented by 2022 at the earliest via the EU Risk Reduction Package in line with the revised Basel Committee timetable for implementation.
- **Standardised counterparty credit risk framework (SA-CCR)** – The Basel Committee issued its final revisions to the standardised counterparty credit risk framework in March 2014. The new requirements will impact upon the calculation of CCR exposures under the standardised approach and are expected to be implemented by 2020 at the earliest via the EU Risk Reduction Package.
- **Leverage** – The EU Risk Reduction Package will introduce a binding minimum leverage ratio requirement of 3 per cent. This is expected to be supplemented through the introduction of leverage ratio buffers aligned to the outcome of the final Basel III reforms. In addition the Package contains multiple revisions to the definition of the leverage ratio exposure measure, combining both certain revisions that feature as part of the final Basel III reforms and additional EU specific revisions. Implementation is expected by 2020 at the earliest.
- **Net stable funding ratio (NSFR)** – The Basel Committee issued its standard for a NSFR in October 2014 as one of the Basel III key reforms to promote a more resilient banking sector, anticipating that it would become a minimum standard by 1 January 2018. The NSFR is expressed as a percentage, calculated as the ratio of an institution's amount of available stable funding to its required stable funding over a one year horizon, with a minimum requirement of 100 per cent on a continual basis. Following a period of consultation, the EU's risk reduction package proposed some EU specific variations from the Basel NSFR standard, and implementation is now expected to be 2020 at the earliest.
- **Pillar 3** – Revisions to the Basel Pillar 3 framework currently reflected through the EBA guidelines on Pillar 3 will be formally adopted through the EU Risk Reduction Package in addition to a range of other EU specific amendments. The revisions are expected to be implemented by 2020 at the earliest.

Other risk framework developments

Other ongoing changes from Basel, Europe (EBA and EU) and UK (PRA) include the following changes which are of most relevance to the Group and span a range of different implementation dates.

- **Sovereign risk** – The Basel Committee published a discussion paper in December 2017 on the regulatory treatment of sovereign exposures. The paper considers a range of options for revising the risk-weight treatment of sovereigns.
- **IRB Repair Programme** – The EBA has issued new regulation impacting IRB modelling approaches. This covers the definition of default, PD, LGD and the treatment of defaulted exposures. Further regulation on Downturn LGD is expected in early 2018. Implementation of these changes is expected to occur by the end of 2020. The effect of this new regulation will also be impacted by the final Basel III reforms in respect of the revisions to the IRB credit risk framework.
- **Mortgage definition of default** – The EBA issued advice in December 2017 to the European Commission on the appropriateness of continuing to apply the 180 days past due (DPD) provision in the definition of default exemption for material exposures, recommending that this exemption be disallowed and all institutions should consequently rely on the 90 DPD regime for all exposures from the end of 2019, subject to an appropriate transition period.
- **Interest rate risk in the banking book (IRRBB)** – An EBA consultation on guidelines on the management of interest rate risk arising from non-trading book activities began in October 2017. These guidelines build upon the EBA Guidelines published in May 2015 and take account of existing supervisory expectations and practices including the Standards on Interest Rate Risk in the Banking Book published by the Basel Committee in April 2016. The BCBS Standards will be implemented within the EU in two phases. Firstly, through the update of the EBA Guidelines planned to become effective from the end of December 2018 and, secondly, through the ongoing revision of the CRD and the CRR. The proposed EBA guidelines uphold the BCBS Standards enhanced Pillar 2A approach for IRRBB capital.
- **Securitisation framework** – The Basel Committee issued final rules in December 2014 on introducing new risk weight methodologies for securitisation positions that have implications for the minimum risk weights applied. The adoption of the new framework has been agreed by EU regulators and will be implemented from 1 January 2019.
- **Mortgage risk weights** – The PRA published final rules in June 2017 that require a new hybrid approach to be applied to mortgage book PD modelling and for LGD sets minimum peak-to-trough house price fall assumptions in Downturn LGD which must be greater than or equal to 25 per cent. The new requirements are to be implemented by the end of 2020.

Minimum requirement for own funds and eligible liabilities (MREL)

The purpose of MREL is to require firms to maintain sufficient equity and liabilities that are capable of credibly bearing losses in resolution. MREL can be satisfied by a combination of regulatory capital and certain unsecured debt resources (which must be subordinate to a firm's operating liabilities).

In November 2016 the Bank of England published a statement of policy on its approach for setting MREL in line with EU requirements.

Applying the Bank of England's MREL policy to current capital requirements, the Group's indicative MREL requirements excluding regulatory capital buffers, is as follows:

- From 2020, 2 times Pillar 1 plus Pillar 2A, equivalent to 21.4 per cent of risk-weighted assets
- From 2022, 2 times Pillar 1 plus 2 times Pillar 2A, equivalent to 26.8 per cent of risk-weighted assets

The Bank of England will review the calibration of MREL in 2020, before setting final end-state MREL requirements to be met in 2022. This review will take into consideration any changes to the capital framework including the finalisation of Basel III.

During 2017, the Group issued £8.5 billion (sterling equivalent as at 31 December 2017) of senior unsecured securities from Lloyds Banking Group plc which, while not included in total capital, are eligible to meet MREL. Combined with previous issuances made during 2016 the Group remains comfortably positioned to meet MREL requirements from 2020 and, as at 31 December 2017, had a transitional MREL ratio of 25.7 per cent of risk-weighted assets.

Capital management

This section details Lloyds Banking Group's approach to capital management, focusing on measures including Common Equity Tier 1 (CET1), Additional Tier 1 (AT1), Tier 2 (T2) and the Leverage Ratio.

CET1 ratio of 14.1% (13.9% pro forma allowing for the announced share buyback)

Transitional T1 capital ratio of 17.2%

Transitional total capital ratio of 21.2%

UK leverage ratio of 5.3% (5.4% pro forma)

- The Group has a capital management framework that is designed to ensure that it operates within its risk appetite, uses its capital resources efficiently and continues to comply with regulatory requirements.
- CET1 capital resources have increased by £0.4bn in the year, primarily reflecting a combination of profit generation, dividends received from the Insurance business during the year, movements in the defined benefit pension schemes and a reduction in the deferred tax asset deducted from capital, partially offset by the payment of the 2017 interim dividend, the accrual of the full year ordinary dividend and an increase in the deduction for goodwill and other intangible assets, largely in relation to the acquisition of MBNA.
- AT1 capital resources have reduced by £0.6bn in the year, primarily reflecting the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments and foreign exchange movements.
- T2 capital resources have reduced by £1.2bn in the year largely reflecting the amortisation of dated tier 2 instruments and foreign exchange movements on subordinated debt, partly offset by the transitioning of grandfathered AT1 instruments to tier 2.
- A description of the main features of CET1, AT1 and T2 instruments issued by the Group and its significant subsidiaries are included in a separate document on the Group's website. Summary information on movements and the underlying terms and conditions of capital securities is presented in Note 38 (Subordinated Liabilities) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.
- The Group's fully loaded UK leverage ratio increased by 0.1 per cent to 5.3 per cent reflecting the impact of both the increase in tier 1 capital and the £8.4 bn reduction in the exposure measure, the latter largely reflecting the underlying reduction in balance sheet assets (net of qualifying central bank claims and deconsolidation adjustments) driven by the reductions in both available-for-sale financial assets and derivatives assets, partially offset by the increase in loans and advances following the acquisition of MBNA and an increase in SFT activity.

Capital management continued

THE GROUP'S APPROACH TO CAPITAL RISK

DEFINITION

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

EXPOSURES

A capital risk exposure arises when 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 needs 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 requires and holds through applying the regulatory framework defined by CRD IV as implemented in the UK by the PRA. Full details of the Group's regulatory capital framework are on pages 13 to 18.

MITIGATION

The Group has a capital management framework including policies and procedures that are designed to ensure that it operates within its risk appetite, uses its capital resources efficiently and continues to comply with regulatory requirements.

The Group is able to accumulate additional capital through the retention of profits over time, which can be enhanced through cutting costs and reducing or cancelling dividend payments, by raising new equity via, for example, a rights issue or debt exchange and by raising AT1 or T2 capital through issuing tier 1 instruments or subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting its lending strategy, risk hedging strategies and through business disposals.

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

MONITORING

Capital is actively managed and monitoring capital ratios is a key factor in the Group's planning processes and stress analyses. Multi-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 plan 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 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.

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

The regulatory framework within which the Group operates continues to evolve and further detail of this can be found under the Future Regulatory Developments heading within the Regulatory Capital Framework section of this report. The Group continues to monitor these developments very closely, analysing the potential capital impacts to ensure that, through organic capital generation, the Group continues to maintain a strong capital position that exceeds both the minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

TARGET CAPITAL RATIOS

The Board's view of the current level of CET1 capital required is c. 13 per cent plus a management buffer of around 1 per cent.

This takes into account, amongst other things:

- the Pillar 2A ICG set by the PRA, reflecting their point in time estimate, which may change over time, of the amount of capital that is needed in relation to risks not covered by Pillar 1. During the year the PRA updated the Group's ICG representing an increase from 4.5 per cent to 5.4 per cent of risk-weighted assets at 31 December 2017, of which 3.0 per cent has to be met by CET1 capital.
- the PRA buffer, which they set taking into account the results of the PRA stress tests and other information, as well as outputs from the Group's internal stress tests. The PRA requires the PRA Buffer itself to remain confidential between the Group and the PRA.
- future regulatory developments, including the introduction of the Systemic Risk buffer in early 2019 and the CCyB on UK exposures during the course of 2018.

The Group maintains capital levels commensurate with a prudent level of solvency and aims to deliver consistent and high quality earnings.

Capital management continued

DIVIDEND POLICY

The Group intends to maintain an ordinary dividend policy that is both progressive and sustainable. The rate of growth of the ordinary dividend will be decided by the Board in light of circumstances at the time.

The Board also gives due consideration to the distribution of surplus capital through the use of special dividends or share buybacks. Surplus capital represents the return of capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties. The amount of required capital may vary from time to time depending on circumstances and by its nature there can be no guarantee that any surplus capital distribution will be appropriate in future years.

The ability of the Group to pay a dividend is also subject to constraints including the availability of distributable reserves, legal and regulatory restrictions and the financial and operating performance of the entity.

Distributable reserves are determined as required by the Companies Act 2006 by reference to a company's individual financial statements. At 31 December 2017 Lloyds Banking Group plc ('the Company') had accumulated distributable reserves of approximately £8.5bn. 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.

Lloyds Banking Group plc acts as a holding company which also issues capital and other securities to capitalise and fund the activities of the Group. The profitability of the holding company, and consequently its ability to sustain dividend payments, is therefore dependent upon the continued receipt of dividends from its subsidiaries (representing both banking and insurance). A number of Group subsidiaries, principally those with banking and insurance activities, are also subject to regulatory capital requirements. These require entities to maintain minimum amounts of capital related to their size and risk. The principal operating subsidiary is Lloyds Bank plc which, at 31 December 2017, had a consolidated CET1 capital ratio of 15.8 per cent (31 December 2016: 15.1 per cent). The Group actively manages the capital of its subsidiaries, which includes monitoring the regulatory capital ratios for its banking and insurance subsidiaries against approved risk appetite limits. It operates a formal capital management policy which requires all subsidiary entities to remit any surplus capital to their parent companies.

ANALYSIS OF CAPITAL POSITION

Excluding the capital impact of the acquisition of MBNA on 1 June 2017, the Group generated 2.45 per cent of CET1 capital on a pro forma basis before ordinary dividends and allowing for the share buyback, primarily as a result of:

- Strong underlying capital generation of 2.5 per cent, largely driven by underlying profits (2.2 per cent) and the dividend paid by the Insurance business in February 2018 in relation to 2017 earnings (0.3 per cent);
- A reduction in risk-weighted assets (prior to the impact of the acquisition of MBNA) resulting in an increase of 0.8 per cent, primarily reflecting updates made to both mortgage and unsecured retail IRB models, continued active portfolio management, foreign exchange movements, disposals and capital efficient securitisation activity, partly offset through targeted growth in key customer segments;
- The impact of market and other movements, generating an increase of 0.4 per cent, partially reflecting positive movements in available-for-sale assets and the defined benefit pension schemes;
- Offset by a reduction of (1.2 per cent) for conduct provisions.

In addition, the Group utilised 0.8 per cent of CET1 capital retained at 31 December 2016 to cover the acquisition of MBNA.

Overall the Group's CET1 ratio has strengthened to 15.5 per cent on a pro forma basis before ordinary dividends and the share buyback. After ordinary dividends the Group's CET1 ratio was 14.4 per cent on a pro forma basis. In addition the Board intends to implement a share buyback programme of up to £1 billion, equivalent to up to 1.4 pence per share. The buyback will impact the Group's capital position in 2018 and is expected to reduce CET1 capital by c.50 basis points. Allowing for this at 31 December 2017 the pro forma CET1 ratio would be 13.9 per cent (31 December 2016: 13.0 per cent pro forma after dividends and adjusting for MBNA). The accrual for foreseeable dividends reflects the recommended final ordinary dividend of 2.05 pence per share.

The transitional total capital ratio, after ordinary dividends reduced by 0.2 per cent to 21.2 per cent, largely reflecting amortisation on dated tier 2 instruments and foreign exchange movements on tier 1 and tier 2 instruments, offset by the increase in CET1 capital and the reduction in risk-weighted assets.

The UK leverage ratio, after ordinary dividends, increased from 5.3 per cent on a pro forma basis to 5.4 per cent on a pro forma basis, largely reflecting the increase in fully loaded tier 1 capital and the underlying reduction in balance sheet assets, net of qualifying central bank claims and deconsolidation adjustments.

An analysis of the Group's capital position as at 31 December 2017 is presented in the following section on both a CRD IV transitional arrangements basis and a CRD IV fully loaded basis.

Capital management continued

CAPITAL RESOURCES

The table below summarises the consolidated capital position of the Group.

Table 4: Capital resources

	Transitional		Fully loaded	
	2017 £m	2016 £m	2017 £m	2016 £m
Common equity tier 1				
Shareholders' equity per balance sheet	**43,551**	43,020	**43,551**	43,020
Adjustment to retained earnings for foreseeable dividends	**(1,475)**	(1,568)	**(1,475)**	(1,568)
Deconsolidation adjustments[1]	**1,301**	1,342	**1,301**	1,342
Adjustment for own credit	**109**	87	**109**	87
Cash flow hedging reserve	**(1,405)**	(2,136)	**(1,405)**	(2,136)
Other adjustments	**(177)**	(276)	**(177)**	(276)
	41,904	40,469	**41,904**	40,469
Less: deductions from common equity tier 1				
Goodwill and other intangible assets	**(2,966)**	(1,623)	**(2,966)**	(1,623)
Prudent valuation adjustment	**(556)**	(630)	**(556)**	(630)
Excess of expected losses over impairment provisions and value adjustments	**(498)**	(602)	**(498)**	(602)
Removal of defined benefit pension surplus	**(541)**	(267)	**(541)**	(267)
Securitisation deductions	**(191)**	(217)	**(191)**	(217)
Significant investments[1]	**(4,250)**	(4,282)	**(4,250)**	(4,282)
Deferred tax assets	**(3,255)**	(3,564)	**(3,255)**	(3,564)
Common equity tier 1 capital	**29,647**	29,284	**29,647**	29,284
Additional tier 1				
Other equity instruments	**5,330**	5,320	**5,330**	5,320
Preference shares and preferred securities[2]	**4,503**	4,998	**–**	–
Transitional limit and other adjustments	**(1,748)**	(1,692)	**–**	–
	8,085	8,626	**5,330**	5,320
Less: deductions from tier 1				
Significant investments[1]	**(1,403)**	(1,329)	**–**	–
Total tier 1 capital	**36,329**	36,581	**34,977**	34,604
Tier 2				
Other subordinated liabilities[2]	**13,419**	14,833	**13,419**	14,833
Deconsolidation of instruments issued by insurance entities[1]	**(1,786)**	(1,810)	**(1,786)**	(1,810)
Adjustments for transitional limit and non-eligible instruments	**1,617**	1,351	**(1,252)**	(1,694)
Amortisation and other adjustments	**(3,524)**	(3,447)	**(3,565)**	(3,597)
	9,726	10,927	**6,816**	7,732
Eligible provisions	**120**	186	**120**	186
Less: deductions from tier 2				
Significant investments[1]	**(1,516)**	(1,571)	**(2,919)**	(2,900)
Total Capital Resources	**44,659**	46,123	**38,994**	39,622
Risk-weighted assets	**210,919**	215,534	**210,919**	215,534
Common equity tier 1 capital ratio (%)[3]	**14.1%**	13.6%	**14.1%**	13.6%
Tier 1 capital ratio (%)	**17.2%**	17.0%	**16.6%**	16.1%
Total capital ratio (%)	**21.2%**	21.4%	**18.5%**	18.4%

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

2 Preference shares, preferred securities and other subordinated liabilities are categorised as subordinated liabilities in the balance sheet.

3 The common equity tier 1 ratio is 14.4% on a pro forma basis upon recognition of the dividend paid by the Insurance business in February 2018 in relation to its 2017 earnings (31 December 2016: 13.8% pro forma).

The key difference between the transitional capital calculation as at 31 December 2017 and the fully loaded equivalent is primarily related to capital securities that previously qualified as tier 1 or tier 2 capital, but that do not fully qualify under CRD IV, which can be included in additional tier 1 (AT1) or tier 2 (T2) capital (as applicable) up to specified limits which reduce by 10 per cent per annum until 2022.

Capital management continued

MOVEMENTS IN CAPITAL

The movements in the transitional CET1, AT1, T2 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 2016	29,284	7,297	9,542	46,123
Profit attributable to ordinary shareholders[1]	2,514	–	–	2,514
Movement in foreseeable dividends[2]	93	–	–	93
Dividends paid out on ordinary shares during the year	(2,284)	–	–	(2,284)
Dividend in respect of 2016 earnings and 2017 interim earnings received from the Insurance business[1]	575	–	–	575
Movement in treasury shares and employee share schemes	3	–	–	3
Pension movements:				
Removal of defined benefit pension surplus	(274)	–	–	(274)
Movement through other comprehensive income	428	–	–	428
Available-for-sale reserve	(74)	–	–	(74)
Prudent valuation adjustment	74	–	–	74
Deferred tax asset	309	–	–	309
Goodwill and other intangible assets	(1,343)	–	–	(1,343)
Excess of expected losses over impairment provisions and value adjustments	104	–	–	104
Significant investments	32	(74)	55	13
Eligible provisions	–	–	(66)	(66)
Movements in subordinated debt:				
Repurchases, redemptions and other	–	(541)	(1,201)	(1,742)
Other movements	206	–	–	206
At 31 December 2017	**29,647**	**6,682**	**8,330**	**44,659**

1 Under the regulatory framework, the profits made by Insurance are removed from CET1 capital. However, when dividends are paid to the Group by Insurance these are recognised through CET1 capital.

2 Includes the accrual for the 2017 full year ordinary dividend and the reversal of the accrual for the 2016 full year ordinary and special dividends which were paid during the year.

CET1 capital resources have increased by £363 million in the year, primarily reflecting a combination of profit generation, dividends received from the Insurance business during the year, movements in the defined benefit pension schemes and a reduction in the deferred tax asset deducted from capital, partially offset by the payment of the 2017 interim dividend, the accrual of the full year ordinary dividend and an increase in the deduction for goodwill and other intangible assets, largely in relation to the acquisition of MBNA.

AT1 capital resources have reduced by £615 million in the year, primarily reflecting the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments and foreign exchange movements.

T2 capital resources have reduced by £1,212 million in the year largely reflecting the amortisation of dated T2 instruments and foreign exchange movements on subordinated debt, partly offset by the transitioning of grandfathered AT1 instruments to T2.

CAPITAL INSTRUMENTS

A description of the main features of CET1, AT1 and T2 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/other-disclosures

Summary information on movements in subordinated liabilities and share capital and the terms and conditions applying to these instruments is presented in the Notes to the Consolidated Financial Statements of the 2017 Lloyds Banking Group plc Annual Report and Accounts on page 215.

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

The recognition, classification and valuation of these instruments within the Group's regulatory capital resources are subject to the requirements of CRD IV. This can lead to a different treatment from the IFRS accounting approach upon which the disclosures within the 2017 Lloyds Banking Group plc 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 adjustments, accrued interest and the regulatory amortisation of dated securities.

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.

Capital management continued

LEVERAGE RATIO

Table 6: Leverage ratio

	Fully loaded	
	2017 £m	2016 £m
Total tier 1 capital for leverage ratio		
Common equity tier 1 capital	**29,647**	29,284
Additional tier 1 capital	**5,330**	5,320
Total tier 1 capital	**34,977**	34,604
Exposure measure		
Statutory balance sheet assets		
Derivative financial instruments	**25,834**	36,138
Securities financing transactions	**49,193**	42,285
Loans and advances and other assets	**737,082**	739,370
Total assets	**812,109**	817,793
Qualifying central bank claims	**(53,842)**	(41,510)
Deconsolidation adjustments[1]		
Derivatives financial instruments	**(2,043)**	(2,403)
Securities financing transactions	**(85)**	112
Loans and advances and other assets	**(140,387)**	(142,955)
Total deconsolidation adjustments	**(142,515)**	(145,246)
Derivatives adjustments		
Adjustment for regulatory netting	**(13,031)**	(20,490)
Adjustment for cash collateral	**(7,380)**	(8,432)
Net written credit protection	**881**	699
Regulatory potential future exposure	**12,335**	13,188
Total derivatives adjustments	**(7,195)**	(15,035)
Securities financing transactions adjustments	**(2,022)**	39
Off-balance sheet items	**58,357**	58,685
Regulatory deductions and other adjustments	**(7,658)**	(9,128)
Total exposure measure[2]	**657,234**	665,598
Average leverage exposure measure[4]	**660,557**	
UK leverage ratio[2,3,6]	**5.3%**	5.2%
Average UK leverage ratio[4]	**5.4%**	
CRD IV leverage exposure measure[5]	**711,076**	707,108
CRD IV leverage ratio[5]	**4.9%**	4.9%

1 Deconsolidation adjustments relate to the deconsolidation of certain Group entities that fall outside the scope of the Group's regulatory capital consolidation, being primarily the Group's Insurance business.

2 Calculated in accordance with the UK Leverage Ratio Framework which requires qualifying central bank claims to be excluded from the leverage exposure measure.

3 The countercyclical leverage ratio buffer is currently nil.

4 The average UK leverage ratio is based on the average of the month end tier 1 capital and exposure measures over the quarter (1 October 2017 to 31 December 2017). The average of 5.4 per cent compares to 5.4 per cent at the start and 5.3 per cent at the end of the quarter.

5 Calculated in accordance with CRD IV rules which include central bank claims within the leverage exposure measure.

6 The UK leverage ratio is 5.4 per cent on a pro forma basis upon recognition of the dividend paid by the Insurance business in February 2018 in relation to its 2017 earnings (31 December 2016: 5.3 per cent pro forma).

Key movements

The Group's fully loaded UK leverage ratio increased by 0.1 per cent to 5.3 per cent reflecting the impact of both the increase in tier 1 capital and the £8.4 billion reduction in the exposure measure, the latter largely reflecting the underlying reduction in balance sheet assets (net of qualifying central bank claims and deconsolidation adjustments) driven by the reductions in both available-for-sale financial assets and derivatives assets, partially offset by the increase in loans and advances following the acquisition of MBNA and an increase in SFT activity.

The derivatives exposure measure, representing derivative financial instruments per the balance sheet net of deconsolidation and derivatives adjustments, reduced by £2.1 billion during the year, primarily driven by market movements and reduction in position levels.

The £4.7 billion increase in the SFT exposure measure during the year, representing SFT assets per the balance sheet net of deconsolidation and other SFT adjustments, reflected an increase in customer volumes, partially offset by reduced trading volumes and an increase in eligible netting adjustments.

Off-balance sheet items reduced by £0.3 billion during the year, primarily reflecting a net reduction in securitisation financing facility commitments together with corporate facility drawdowns, reductions and exits, largely offset by an increase in unconditionally cancellable credit card commitments following the acquisition of MBNA and new residential mortgage offers placed.

The average UK leverage ratio of 5.4 per cent over the quarter reflected a strengthening tier 1 capital position prior to the accrual for the announced full year ordinary dividend and further conduct provisions, and the reduction in underlying balance sheet assets during the quarter, net of qualifying central bank claims.

Pillar 1 Capital requirements: Overview of risk-weighted assets

This section details Lloyds Banking Group's risk-weighted assets and pillar 1 capital requirements.

– The risk-weighted assets movement table provides analysis of the reduction in risk-weighted assets in the period by risk type and an insight into the key drivers of the movements. The key driver analysis is compiled on a monthly basis through the identification and categorisation of risk-weighted asset movements and is subject to management judgment.

– Credit risk-weighted assets account for 78% of fully loaded risk-weighted assets.

Table 7: Risk-weighted assets movement by key driver

	Credit Risk IRB £m	Credit Risk STA £m	Credit Risk Total[1] £m	Counterparty Credit Risk[2] £m	Market Risk £m	Operational Risk £m	Total £m
Total risk-weighted assets as at 31 December 2016							**215,534**
Less: total threshold risk-weighted assets[3]							**(10,851)**
Risk-weighted assets at 31 December 2016	**147,665**	**18,956**	**166,621**	**9,623**	**3,147**	**25,292**	**204,683**
Asset size	**(2,465)**	**100**	**(2,365)**	**(403)**	**–**	**–**	**(2,768)**
Asset quality	**322**	**(112)**	**210**	**(222)**	**–**	**–**	**(12)**
Model updates	**(4,399)**	**–**	**(4,399)**	**–**	**349**	**–**	**(4,050)**
Methodology and policy	**(789)**	**434**	**(355)**	**(431)**	**–**	**–**	**(786)**
Acquisitions and disposals	**(606)**	**6,237**	**5,631**	**(26)**	**–**	**930**	**6,535**
Movement in risk levels (market risk only)	**–**	**–**	**–**	**–**	**(445)**	**–**	**(445)**
Foreign exchange movements	**(742)**	**(112)**	**(854)**	**(656)**	**–**	**–**	**(1,510)**
Other	**–**	**–**	**–**	**–**	**–**	**(896)**	**(896)**
Risk-weighted assets at 31 December 2017	**138,986**	**25,503**	**164,489**	**7,885**	**3,051**	**25,326**	**200,751**
Threshold risk-weighted assets[3]							**10,168**
Total risk-weighted assets as at 31 December 2017							**210,919**

1 Credit risk includes securitisation risk-weighted assets.

2 Counterparty credit risk includes movements in contributions to the default fund of central counterparties and movements in credit valuation adjustment risk.

3 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital. Significant investments primarily arise from investments in the Group's Insurance business.

Key movements

Movements in **credit risk-weighted** assets in the twelve months to 31 December 2017 were driven by the following:

- **Asset size** saw a reduction of £2.4bn due to continued active portfolio management, partly offset by targeted growth in key customer segments.
- **Model update** reductions of £4.4bn were mainly due to PRA approved model changes within the mortgage and unsecured retail portfolios.
- **Methodology and policy** reductions of £0.4bn were principally the result of further capital efficient securitisation activity.
- **Acquisitions and disposals** increased by £5.6bn and were primarily driven by the acquisition of MBNA, partly offset by disposal of the Group's interest in a strategic equity investment.
- **Sterling foreign exchange movements,** principally with Euro and US Dollar, contributed to an overall reduction in credit risk-weighted assets of £0.9bn.

Counterparty Credit Risk and CVA risk-weighted assets reductions of £1.7bn were mainly driven by foreign exchange movements, reductions in position levels, updates to the calculation methodology following clarification of the regulatory approach and other movements.

Market risk, risk-weighted assets reduced by of £0.1bn largely due to decrease in interest rate risk exposure, offset by an increase in the VaR multiplier, an increase in exposure to corporate bonds and refinements to internal models.

Operational risk, risk-weighted assets are broadly in line with the prior year, with the increase following the acquisition of MBNA mostly offset by the annual update of the income based Standardised Approach operational risk calculation.

Pillar 1 Capital requirements: Overview of risk-weighted assets continued

Table 8: Overview of risk-weighted assets (OV1)

	2017 RWA £m	2016 RWA £m	2017 Minimum capital Requirements £m	2016 Minimum capital Requirements £m
Credit risk (excluding counterparty credit risk)	**160,301**	162,650	**12,824**	13,012
of which: standardised approach	**25,259**	18,688	**2,021**	1,495
of which: the foundation rating-based (FIRB) approach	**48,242**	51,438	**3,859**	4,115
of which: the retail IRB (RIRB) approach	**61,588**	64,970	**4,927**	5,198
of which: corporates – specialised lending	**11,965**	13,469	**957**	1,077
of which: non-credit obligation assets	**5,866**	6,427	**469**	514
of which: equity IRB under the simple risk-weight or the internal models approach	**7,381**	7,658	**591**	613
Counterparty credit risk	**7,885**	9,623	**631**	770
of which: marked to market	**5,481**	7,552	**439**	604
of which: original exposure	**–**	–	**–**	–
of which: the standardised approach	**–**	–	**–**	–
of which: internal ratings-based model method (IMM)	**–**	–	**–**	–
of which: comprehensive approach for credit risk mitigation (for SFTs)	**403**	712	**32**	57
of which: exposures to central counterparties (including trades, default fund contributions and initial margin)	**599**	495	**48**	40
of which: credit valuation adjustment (CVA)	**1,402**	864	**112**	69
Settlement risk	**–**	–	**–**	–
Securitisation exposures in banking book	**4,188**	3,971	**335**	318
of which: IRB ratings-based approach (RBA)	**3,167**	2,878	**253**	231
of which: IRB supervisory formula approach (SFA)	**46**	–	**4**	–
of which: internal assessment approach (IAA)	**731**	825	**58**	66
of which: standardised approach	**244**	268	**20**	21
Market risk	**3,051**	3,147	**244**	252
of which: standardised approach	**395**	352	**32**	28
of which: internal model approaches	**2,656**	2,795	**212**	224
Large exposures	**–**	–	**–**	–
Operational risk	**25,326**	25,292	**2,026**	2,023
of which: basic indicator approach	**–**	–	**–**	–
of which: standardised approach	**25,326**	25,292	**2,026**	2,023
of which: advanced measurement approach	**–**	–	**–**	–
Amounts below the thresholds for deduction (subject to 250% risk weight)	**10,168**	10,851	**813**	868
Floor adjustment	**–**	–	**–**	–
Total	**210,919**	215,534	**16,874**	17,243

A detailed analysis of the key movements in exposures and risk-weighted assets is provided in Table 23.

Pillar 1 Capital requirements: Overview of risk-weighted assets continued

DIVISIONAL RISK-WEIGHTED ASSETS

The risk-weighted assets of the divisions as at 31 December 2017 are presented in the table below.

For explanations on key movements in credit risk divisional risk-weighted assets refer to Table 11 on page 32.

Table 9: Divisional risk-weighted assets

	2017 Retail £m	2017 Commercial Banking £m	2017 Insurance and Wealth[1] £m	2017 Central Items[2] £m	2017 Run-off £m	2017 Total £m
CREDIT RISK						
Exposures subject to the IRB approach						
Central governments or central banks	–	2	–	1,414	–	1,416
Institutions	99	856	–	132	–	1,087
Corporates	3,455	53,311	–	5	932	57,703
of which: Specialised lending	–	11,519	–	–	446	11,965
of which: SMEs	33	7,568	–	–	7	7,608
Retail	54,877	3,115	–	–	3,596	61,588
Secured by real estate property	30,761	2,406	–	–	3,596	36,763
SMEs	148	2,406	–	–	–	2,554
Non-SMEs	30,613	–	–	–	3,596	34,209
Qualifying revolving	11,142	–	–	–	–	11,142
Other retail	12,975	709	–	–	–	13,684
SMEs	869	709	–	–	–	1,578
Non-SMEs	12,106	–	–	–	–	12,106
Equity	66	103	–	6,923	289	7,381
Non-credit obligation assets	2,220	17	–	3,621	9	5,866
Total – IRB approach	60,717	57,404	–	12,095	4,826	135,042
Exposures subject to the standardised approach						
Central governments or central banks	–	–	–	8	–	8
Regional governments or local authorities	–	1	–	–	–	1
Public sector entities	–	21	–	–	–	21
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	18	9	–	1	4	32
Corporates	1,045	8,365	217	1,010	265	10,902
Retail	7,250	1,115	275	–	616	9,256
Secured by mortgages on immovable property	970	355	75	207	337	1,944
of which: residential property	968	355	75	207	337	1,942
of which: commercial property	2	–	–	–	–	2
Exposures in default	463	129	27	–	146	765
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investment undertakings	–	–	–	56	–	56
Equity	–	–	–	–	–	–
Other items	609	341	49	1,119	156	2,273
Total – Standardised approach	10,355	10,336	643	2,401	1,524	25,259
Total credit risk (excluding securitisations)	71,072	67,740	643	14,496	6,350	160,301
Securitisation positions – IRB approach	–	3,200	–	–	744	3,944
Securitisation positions – Standardised approach	–	244	–	–	–	244
Total credit risk (including securitisations)	71,072	71,184	643	14,496	7,094	164,489
Threshold – significant investments	–	–	–	8,474	–	8,474
Threshold – deferred tax	–	–	–	1,694	–	1,694
Total credit risk	71,072	71,184	643	24,664	7,094	174,657

Pillar 1 Capital requirements: Overview of risk-weighted assets continued

	2017 Retail £m	2017 Commercial Banking £m	2017 Insurance and Wealth[1] £m	2017 Central Items[2] £m	2017 Run-off £m	2017 Total £m
COUNTERPARTY CREDIT RISK						
IRB approach	–	5,125	–	256	–	5,381
Standardised approach	–	200	–	303	–	503
Central counterparties	–	171	–	–	–	171
Settlement risk	–	–	–	–	–	–
Contributions to the default fund of a central counterparty	–	428	–	–	–	428
Total counterparty credit risk	–	5,924	–	559	–	6,483
Credit valuation adjustment						
Standardised method	–	1,182	–	220	–	1,402
Total credit valuation adjustment	–	1,182	–	220	–	1,402
MARKET RISK						
Internal models approach	–	2,656	–	–	–	2,656
Standardised approach						
Interest rate position risk requirement	–	322	–	–	–	322
of which: specific interest rate risk of securitisation positions	–	28	–	–	–	28
Equity position risk requirement	–	–	–	–	–	–
Foreign exchange position risk requirement	–	43	–	30	–	73
Commodity position risk requirement	–	–	–	–	–	–
Total market risk	–	3,021	–	30	–	3,051
OPERATIONAL RISK						
Standardised approach	19,740	4,319	621	446	200	25,326
Total operational risk	19,740	4,319	621	446	200	25,326
Total risk-weighted assets	90,812	85,630	1,264	25,919	7,294	210,919

1 The risk-weighted assets relate to Wealth only. As a separate regulated business, Insurance maintains its own regulatory solvency requirements, including appropriate management buffers, and reports directly to the Insurance Board. Insurance does not hold any risk-weighted assets, as its assets are removed from the Banking Group's regulatory capital calculations. However, in accordance with CRD IV rules, part of the Group's investment in Insurance is included in the calculation of threshold risk-weighted assets, while the remainder is taken as a capital deduction.

2 Central items include assets held outside the main operating divisions, including assets relating to Group Corporate Treasury, which holds the Group's liquidity portfolio, and Group Operations.

Pillar 1 Capital requirements: Overview of risk-weighted assets continued

	2016 Retail[1] £m	2016 Commercial Banking[1] £m	2016 Insurance and Wealth[1] £m	2016 Central Items[1,2] £m	2016 Run-off £m	2016 Total £m
CREDIT RISK						
Exposures subject to the IRB approach						
Central governments or central banks	–	–	–	1,430	–	1,430
Institutions	67	639	–	251	–	957
Corporates	3,214	57,798	–	5	1,503	62,520
of which: Specialised lending	–	12,869	–	–	600	13,469
of which: SMEs	29	7,707	–	–	144	7,880
Retail	58,018	3,364	–	–	3,587	64,969
Secured by real estate property	33,482	2,481	–	–	3,587	39,550
SMEs	181	2,481	–	–	–	2,662
Non-SMEs	33,301	–	–	–	3,587	36,888
Qualifying revolving	12,073	–	–	–	–	12,073
Other retail	12,463	884	–	–	–	13,347
SMEs	844	884	–	–	–	1,728
Non-SMEs	11,618	–	–	–	–	11,618
Equity	–	102	–	7,112	445	7,659
Non-credit obligation assets	1,825	78	1	4,510	13	6,427
Total – IRB approach	63,124	61,981	1	13,308	5,548	143,962
Exposures subject to the standardised approach						
Central governments or central banks	–	–	–	–	–	–
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	–	2	–	–	–	2
Multilateral development banks	–	–	–	–	–	–
International organisations	–	–	–	–	–	–
Institutions	22	8	–	86	1	117
Corporates	801	7,929	297	1,238	536	10,801
Retail	830	1,016	291	–	624	2,761
Secured by mortgages on immovable property	1,077	356	39	104	405	1,981
of which: residential property	1,074	356	39	104	405	1,978
of which: commercial property	3	–	–	–	–	3
Exposures in default	522	163	17	–	181	883
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investment undertakings	–	–	–	45	–	45
Equity	–	–	–	–	–	–
Other items	624	360	41	932	141	2,098
Total – Standardised approach	3,876	9,834	685	2,405	1,888	18,688
Total credit risk (excluding securitisations)	67,000	71,815	686	15,713	7,436	162,650
Securitisation positions – IRB approach	–	2,726	–	143	834	3,703
Securitisation positions – Standardised approach	–	268	–	–	–	268
Total credit risk (including securitisations)	67,000	74,809	686	15,856	8,270	166,621
Threshold – significant investments	–	–	–	8,392	–	8,392
Threshold – deferred tax	–	–	–	2,459	–	2,459
Total credit risk (transitional)	67,000	74,809	686	26,707	8,270	177,472

Pillar 1 Capital requirements: Overview of risk-weighted assets continued

	2016 Retail[1] £m	2016 Commercial Banking[1] £m	2016 Insurance and Wealth[1] £m	2016 Central Items[1,2] £m	2016 Run-off £m	2016 Total £m
COUNTERPARTY CREDIT RISK						
IRB approach	–	7,245	–	446	–	7,691
Standardised approach	–	249	–	324	–	573
Central counterparties	–	155	–	–	–	155
Settlement risk	–	–	–	–	–	–
Contributions to the default fund of a central counterparty	–	340	–	–	–	340
Total counterparty credit risk	–	7,989	–	770	–	8,759
Credit valuation adjustment						
Standardised method	–	586	–	278	–	864
Total credit valuation adjustment	–	586	–	278	–	864
MARKET RISK						
Internal models approach	–	2,795	–	–	–	2,795
Standardised approach						
Interest rate position risk requirement	–	297	–	–	–	297
of which: specific interest rate risk of securitisation positions	–	17	–	–	–	17
Equity position risk requirement	–	–	–	–	–	–
Foreign exchange position risk requirement	–	59	–	(4)	–	55
Commodity position risk requirement	–	–	–	–	–	–
Total market risk	–	3,151	–	(4)	–	3,147
OPERATIONAL RISK						
Standardised approach	17,602	6,031	1,005	421	233	25,292
Total operational risk	17,602	6,031	1,005	421	233	25,292
Total risk-weighted assets	84,602	92,566	1,691	28,172	8,503	215,534

1 Restated.

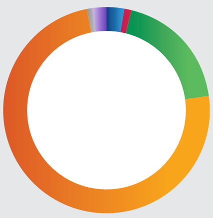
2 Central items include assets held outside the main operating divisions, including assets relating to Group Corporate Treasury, which holds the Group's Liquidity Portfolio, and Group Operations.

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.

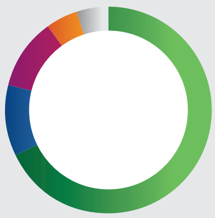
- The Group remained focused on the UK, which generates over 87% of credit risk exposures.
- Of the Group's credit risk exposures, 82% (£533.9bn) are risk-weighted under the IRB approach, with the remainder (£113.3bn) risk-weighted using the Standardised approach. Standardised exposures include MBNA assets which are on an IRB roll-out plan.
- Total credit risk risk-weighted assets decreased by 1% to £160.3bn, primarily due to active portfolio management, disposals and model changes, offset by the acquisition of MBNA.
- The Group's average risk weight for credit risk exposures remained stable.
- During 2017 expected losses and specific credit risk adjustments (SCRA) have decreased by £0.2bn and £0.3bn respectively, primarily due to active portfolio management.
- The Group's models continue to maintain a conservative approach.

IRB exposures



Central governments or central banks 3%	(2016: 3%)
Institutions 1%	(2016: 1%)
Corporates 19%	(2016: 20%)
Retail 74%	(2016: 73%)
Equities 1%	(2016: 1%)
Non-credit obligation assets 2%	(2016: 2%)

Standardised exposures



Central governments or central banks 68%	(2016: 77%)
Corporates 11%	(2016: 10%)
Retail 11%	(2016: 4%)
Secured by mortgages on immovable property 5%	(2016: 5%)
Other[1] 5%	(2016: 6%)

1 Other includes regional governments or local authorities, public sector entities, multilateral development banks, institutions, exposures in default and other balance sheet assets that have no associated credit risk.

Table 10: Risk-weighted assets flow statements of credit risk exposures (CR8)

	Credit Risk IRB RWA amount Total £m	Credit Risk IRB Capital Requirements £m	Credit Risk STD RWA amount Total £m	Credit Risk STD Capital requirements Total £m
Risk-weighted assets at 31 December 2016[1]	**147,665**	**11,814**	**18,956**	**1,516**
Asset size	(2,465)	(197)	100	8
Asset quality	322	25	(112)	(9)
Model updates	(4,399)	(352)	–	–
Methodology and policy	(789)	(63)	434	35
Acquisitions and disposals	(606)	(49)	6,237	499
Foreign exchange movements	(742)	(59)	(112)	(9)
Other	–	–	–	–
Risk-weighted assets at 31 December 2017[1]	**138,986**	**11,119**	**25,503**	**2,040**

1 Credit risk, risk-weighted assets and capital requirements in Table 10 are inclusive of securitisations. At 31 December 2017 IRB securitisation risk-weighted assets were £3,949m (2016: £3,703m) and standardised securitisation risk-weighted assets were £244m (2016: £268m).

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 financial obligations (both on or off balance sheet).

RISK APPETITE

The Group has a conservative and well balanced credit portfolio managed through the economic cycle.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances, contingent liabilities, commitments, debt securities and equity with customers, financial institutions and sovereigns. Credit risk exposures are categorised as 'retail', arising primarily in the Retail and Run-off divisions, and some small and medium sized enterprises (SMEs), and 'corporate' (including larger SMEs, corporates, banks, financial institutions and sovereigns) arising primarily in the Commercial Banking, Wealth, Run-off and Central Items divisions.

In terms of loans and advances (for example loans and overdrafts) and contingent liabilities (for example credit instruments such as guarantees and standby, documentary and commercial letters of credit), credit risk arises both from amounts advanced, and commitments to extend credit to a customer or bank.

With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit may be cancelled and the creditworthiness of customers is monitored regularly. Most commercial term commitments to extend credit are contingent upon customers maintaining specific credit standards, which together with the creditworthiness of customers, are monitored regularly.

The credit risk exposures of the Group from a regulatory capital perspective, as defined by the CRR, are included throughout the Pillar 3 disclosures.

Exposures and risk-weighted assets values presented in this section (Pillar 1 Capital requirements: Credit risk) exclude securitisation positions in line with the EBA prescribed format. This presentation is reflected in both current and comparative numbers. For certain tables this may be different from the analysis presented in 2016 Pillar 3 document (analysis of exposures by exposure class, industry, geography and maturity).

An analysis of total credit risk exposures and risk-weighted assets by division is provided below. Exposures presented are on a pre CRM and post CCF basis.

Table 11: Divisional credit risk exposures and risk-weighted assets

Division	Risk Weight approach	2017 Credit risk exposure £m	2017 Risk-weighted assets £m	2017 Average risk weight %	2016 Credit risk exposure[1] £m	2016 Risk-weighted assets[1] £m	2016 Average risk weight[1] %
Retail	IRB	390,682	60,717	16%	385,139	63,124	16%
	Standardised	15,120	10,355	68%	6,829	3,876	57%
Commercial Banking	IRB	109,788	57,404	52%	115,733	61,981	54%
	Standardised	12,779	10,336	81%	12,772	9,834	77%
Insurance and Wealth	IRB	–	–	–	1	1	100%
	Standardised	903	643	71%	856	685	80%
Central Items	IRB	27,407	12,095	44%	27,588	13,308	48%
	Standardised	81,991	2,401	3%	86,558	2,405	3%
Run-off	IRB	5,975	4,826	81%	7,308	5,548	76%
	Standardised	2,466	1,524	62%	3,273	1,888	58%
Total		647,111	160,301	25%	646,057	162,650	25%
	Total IRB	533,852	135,042	25%	535,769	143,962	27%
	Total Standardised	113,259	25,259	22%	110,288	18,688	17%

1 Restated.

Key movements

Retail risk-weighted assets increased by £4.1bn mainly as a result of the acquisition of MBNA, partially offset by PRA approved model changes.

Commercial Banking risk-weighted assets decreased by £4.1bn mainly as a result of continued active portfolio management, including capital efficient securitisation activity.

Central Items risk-weighted assets decreased by £1.2bn due to reductions on other asset balances and the disposal of some of the Group's strategic equity investments.

Run-off risk-weighted assets decreased by £1.1bn driven by disposals.

Pillar 1 Capital requirements: Credit risk continued

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 (PD) of 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 (EAD); and

(iii) the likely loss ratio on the defaulted obligations the loss given default (LGD).

EAD includes on-balance sheet netting where permissible, however, the Group does not practice off-balance sheet netting on its credit risk exposures.

For regulatory capital purposes the Group's credit risk exposures are measured as risk-weighted assets, primarily calculated using Internal Ratings Based approach, with the remainder calculated under the Standardised approach. The Group's application of these approaches is explained in more detail on pages 14 and 15.

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. 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, Group Risk Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis, as outlined on pages 39 to 40.

Further details are provided on pages 116 to 119 of the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

CREDIT RISK MITIGATION

The Group uses a range of approaches to mitigate credit risk. For detailed information on approaches to mitigate credit risk, including details of the Group's policies and principles, see pages 116 to 118 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Collateral

The Group maintains appetite guidelines on the acceptability of specific classes of collateral. Only certain types of collateral are deemed eligible for internal risk management and regulatory capital purposes. The recognition of eligible collateral requires a number of factors to be considered such as legal certainty of charge, frequency and independency of revaluation and correlation of the value of the underlying asset to the obligor.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the underlying exposure. Debt securities including 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, however 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.

No collateral is held in respect of retail credit cards, overdrafts or unsecured personal lending. For non-mortgage retail lending to small businesses, collateral may include second charges over residential property and the assignment of life cover.

The additional mitigation for Retail and Commercial customers is explained in more detail on page117 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Where collateral is held, the eligible collateral for loans and advances and contingent liabilities is classified as either financial collateral or other collateral, as outlined below:

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 its corporate (IRB and Standardised) and institutions (IRB) exposures.

Other eligible collateral

- Real estate collateral includes charges over residential and commercial properties, for example, for the Group's mainstream mortgages.
- Other eligible collateral includes real estate, short term financial receivables, credit insurance, life policies and other physical collateral for example, vehicles, providing the criteria for eligibility are met.
- The Group largely applies other eligible collateral to the IRB corporate main, corporate SME and retail asset classes.

Collateral values are assessed at the time of loan origination. The Group requires collateral to be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. In certain circumstances, for Retail residential mortgages this may include the use of automated valuation models based on market data, subject to accuracy criteria and loan to value limits. Collateral values are reviewed on a regular basis and will vary according to the type of lending, collateral involved and account performance. Such reviews are undertaken to confirm that the value recorded in the Bank's systems remains appropriate and whether revaluation is required, considering for example, account performance, market conditions and any information available that may indicate that the value of the collateral has materially declined. In such instances, the Group may seek additional collateral. For assets with collateral the Group adjusts open market values to take account of the costs of realisation and any discount associated with the realisation of the collateral when estimating credit losses.

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 page 117 of the Risk Management section and Note 51 (Financial Risk Management) of the 2017 Lloyds Banking Group plc Annual Report and Accounts for further information on collateral.

Pillar 1 Capital requirements: Credit risk continued

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.

– 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 (CLN) (to the extent of their cash funding).
– The Group makes limited use of credit derivatives as credit risk mitigation from a capital perspective.
– Further details on the application within the Group are included within the Counterparty credit risk section of the document on page 88.

Guarantees

– In addition, guarantees from eligible protection providers including governments, institutions and corporates, can also provide regulatory capital relief, although there are minimum operational and legal requirements which must be met before reflecting the risk mitigating effect. On the basis that these requirements 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 for guarantees provided by appropriate sovereigns, institutions or corporates, as well as for collateralised guarantees from corporates where available.

APPLICATION OF CREDIT RISK MITIGATION
The Group's application of different types of credit risk mitigation from a regulatory capital perspective is outlined below:

	Standardised		IRB		
	EAD	Other	EAD	LGD	PD
Eligible financial collateral					
trading book	✓		✓		
non-trading book	✓			✓	
Other eligible collateral					
real estate collateral[1]		✓		✓	✓
other physical collateral				✓	✓
credit insurance[2]		✓			✓
receivables	✓			✓	
life policies	✓			✓	
Credit derivatives[2]		✓			✓
Collateralised guarantees[2]		✓		✓	
Non collateralised guarantees[2]		✓			✓

1 Real estate collateral determines the exposure class under the Standardised Approach as explained below.
2 As per application under the PD Substitution Approach (IRB), 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 and appropriate value discounts as needed.

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 and counterparty credit risk exposures are discussed further within the Securitisation and Counterparty credit risk section of the document.

Collateral may also be used as an input for modelling SCRAs against exposures, which will also indirectly reduce the EAD for exposures subject to the Standardised Approach.

Application under the IRB approach
In recognising eligible financial collateral under the FIRB 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 and appropriate value discounts as neded.

Other eligible collateral, collateralised guarantees and real estate collateral applied under the FIRB 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.

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.

Under the Retail IRB Approach, own estimates of LGD are used, taking into account eligible collateral, including real estate collateral or other physical collateral, among other factors. As well as impacting LGD, real estate collateral may also influence a counterparty's PD under the Retail IRB approach in certain cases, for example, for residential mortgages.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK MITIGATION

The following table provides an analysis of net carrying values of credit risk exposures secured by different CRM techniques split by regulatory approach and asset class.

Table 12: CRM techniques – Overview (CR3)

	2017				
	Exposures unsecured – carrying amount £m	Exposures to be secured[1] £m	Exposures secured by collateral[2] £m	Exposures secured by financial guarantees £m	Exposures secured by credit derivatives[3] £m
Exposures subject to the IRB approach					
Central governments or central banks	17,722	–	–	–	–
Institutions	3,381	1,406	245	28	1,133
Corporates	73,836	45,062	44,894	168	–
of which: Specialised lending	–	16,927	16,927	–	–
of which: SMEs	4,386	7,909	7,909	–	–
Retail	62,052	328,450	328,450	–	–
Secured by real estate property	–	318,833	318,833	–	–
SMEs	–	9,761	9,761	–	–
Non-SMEs	–	309,072	309,072	–	–
Qualifying revolving	51,968	–	–	–	–
Other retail	10,083	9,617	9,617	–	–
SMEs	2,150	34	34	–	–
Non-SMEs	7,933	9,583	9,583	–	–
Equity	3,355	–	–	–	–
Non-credit obligation assets	10,231	–	–	–	–
Total – IRB approach	170,576	374,918	373,589	196	1,133
Exposures subject to the standardised approach					
Central governments or central banks	76,416	263	–	263	–
Regional governments or local authorities	5	–	–	–	–
Public sector entities	41	–	–	–	–
Multilateral development banks	1,837	–	–	–	–
International organisations	–	–	–	–	–
Institutions	146	237	237	–	–
Corporates	17,162	880	818	62	–
Retail	33,935	150	150	–	–
Secured by mortgages on immovable property	–	5,158	5,158	–	–
Exposures in default	255	446	446	–	–
Items associated with particularly high risk	–	–	–	–	–
Covered bonds	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–
Collective investment undertakings	278	–	–	–	–
Equity exposures	–	–	–	–	–
Other exposures	3,114	–	–	–	–
Total – standardised approach	133,189	7,134	6,809	325	–
Total exposures	303,764	382,052	380,398	521	1,133
of which: defaulted	1,716	4,206	4,206	–	–

1 Allocation of the carrying amount of multi-secured exposures is made by order of priority to their different CRM techniques.

2 At 31 December 2017 the value of exposures secured by eligible financial collateral is £5.5bn and the value of exposures secured by other eligible collateral is £374.9bn.

3 Exposures secured by credit derivatives mainly represents Corporate exposures where the risk has been transferred into Institutions.

Further details on collateral held as security for financial assets, collateral pledged as security and collateral repossessed can be found in Note 51 (Financial risk management) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk continued

INTERNAL RATING SCALES

Within the Group, internal PD rating scales are used in assessing the credit quality of the Foundation IRB and Retail IRB portfolios. Two master scales are used for external reporting purposes within the business – a Corporate master scale which covers all relevant corporate, central government or central bank and institution portfolios and a Retail master scale which covers all relevant retail portfolios.

PD master scales

Table 13: Internal Corporate master scale

In corporate portfolios the PD models segment counterparties into a number of rating grades, with each grade representing a defined range of default probabilities, and there are a number of different model rating scales. Counterparties/exposures migrate between rating grades if the assessment of the PD changes. The modelled PDs 'map' to the single Corporate (non-retail) master scale comprising of 19 non-default ratings. Together with four default ratings the corporate master scale forms the basis on which internal reporting is completed. These ratings scales can also be mapped to external ratings as shown below.

	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 14: Internal Retail master scale

For reporting purposes, customers are segmented into a number of rating grades, each representing a defined range of default probabilities and exposures migrate between rating grades if the assessment of the counterparty PD changes. The Retail master scale comprises 13 non-default ratings and one default rating.

	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%

Pillar 1 Capital requirements: Credit risk continued

DISTRIBUTION OF EXPOSURES BY APPROACH

To illustrate the degree to which IRB models are used within the bank, the table below shows the EAD split between RIRB, FIRB and Standardised approaches across the different Basel asset classes for which IRB models are in place. Exposures presented in the table below are in line with Table 23, and are on a pre CRM and post CCF basis. The proportion of standardised assets has increased by 2% this year, following the acquisition of MBNA which is on the Group's IRB roll-out plan.

	RIRB £m	FIRB £m	Other IRB £m	Standardised £m
Central governments or central banks	–	17,722	–	76,438
Institutions[1]	–	4,173	–	2,052
Corporates[2]	–	87,112	16,596	12,724
Retail - Secured by property	334,359	–	–	5,153
Retail – Qualifying revolving	40,285	–	–	–
Retail – Other	20,043	–	–	12,819
Other[3]	–	–	13,562	4,072
Total	394,687	109,007	30,158	113,259
% coverage	61%	17%	4%	18%

1 Standardised institutions exposures also include regional governments or local authorities, public sector entities and multilateral development banks.

2 Corporate Other IRB exposures represent exposures risk-weighted under the Supervisory Slotting Approach.

3 Other exposures include IRB equity and non-credit obligations and Standardised exposures in default, collective investment undertakings and other exposures.

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 (used for corporate exposures, institutions and central governments or central banks) 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, hence no models are used for these two groups. Securitisation positions are predominantly risk-weighted under the Ratings Based Approach (RBA), with some use made of the Internal Assessment Approach (IAA) and Standardised Approach (SA).

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.

Under the Group's IRB rating permission, the following list comprises the rating systems that are significant at a group level, each having risk-weighted assets in excess of £2.5bn (based on risk-weighted asset figures in the CRR attestation, September 2017); this threshold is unchanged from last year's Pillar 3 disclosure. The models listed here are the same as used in the PD backtesting analysis (later in this section) with the exception of PELF and Quasi State. These are excluded from backtesting due to the very low level of defaults.

Approach	Basel asset class	Ratings system	Associated portfolio (risk-weighted assets)
RIRB	Retail mortgages	HBOS Mainstream and Lloyds Bank mortgages[1,2]	>£15bn
FIRB	Corporate Main, Corporate SME	Publicly Quoted[6]	£10-£15bn
FIRB	Corporate Main, Corporate SME	Unquoted[6]	£10-£15bn
FIRB/RIRB	Corporate SME, Retail SME and Retail mortgages	Business Dynamic Credit Scoring (BDCS)[3]	£5bn – £10bn
RIRB	Retail – Other (non-SME)	HBOS and Lloyds Bank loans[1]	£5bn – £10bn
RIRB	Retail – Qualifying revolving	HBOS and Lloyds Bank credit cards[1,5]	£5bn – £10bn
RIRB	Retail mortgages	HBOS Buy-to-Let mortgages	£5bn – £10bn
RIRB	Retail mortgages	HBOS Other mortgages[4]	£2.5bn – £5bn
RIRB	Retail mortgages	BOS Ireland mortgages	£2.5bn – £5bn
RIRB	Retail – Qualifying revolving	HBOS and Lloyds Bank overdrafts[1]	£2.5bn – £5bn
FIRB	Corporate Main	Private Equity & Loan Fund (PELF)	£2.5bn – £5bn
FIRB	Corporate Main	Quasi State	£2.5bn – £5bn
FIRB	Corporate Main	UK Motor Finance (Commercial)	£2.5bn – £5bn
RIRB	Retail – Other (non-SME)	UK Motor Finance (Retail)	£2.5bn – £5bn

1 Separate rating systems exist for Lloyds Bank and HBOS but as the risk profiles and models used are very similar, they are grouped together in this table.

2 Lloyds Bank mortgages comprises three rating systems - Lloyds Mainstream mortgages, Lloyds Near-Mainstream mortgages and Lloyds Buy-to-Let mortgages.

3 There is a very small element of Corporate Main under the BDCS model. BDCS is Lloyds Bank only.

4 These are all closed books with HBOS Self Certified Mortgages being the largest.

5 MBNA exposures are currently rated on the Standardised approach.

6 Publicly Quoted and Unquoted rating systems have a small number of obligors which are included in the Institutions asset class.

Pillar 1 Capital requirements: Credit risk continued

KEY CHARACTERISTICS OF MATERIAL GROUP RATINGS SYSTEMS

PD rating philosophy

PD ratings generally adhere to either 'Point-in-time' (PIT) or 'Through-the-cycle' (TTC) rating approaches.

– For Qualifying Revolving Retail Exposures (QRRE) and Retail – Other (non-SME), PD ratings are constructed on a PIT basis with a PD 'buffer' added to the pure PIT PD to cover potential underestimation of default risk between regular calibrations.

– Retail mortgages use a TTC approach where this is available (Lloyds Bank and Halifax Mainstream mortgages) and a PIT approach with a PD buffer otherwise.

– Corporate PD models are largely calibrated to a long-run of default experience, meaning the PD predictions are more TTC in nature. The material exception to this being BDCS, which is more PIT in nature.

With the exception of the UK retail mortgage portfolios, models use a 90 days-past-due backstop; UK retail mortgage portfolios (except those rated through BDCS) use a 180 days-past-due backstop. Unlikeliness to pay triggers vary by portfolio using criteria such as bankruptcy/IVAs, repossessions and forbearance treatments.

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 commercial portfolios this includes counterparty quantitative (e.g. financial) and qualitative (e.g. assessment of management) factors.

EAD and LGD modelling approach

Corporate exposures are rated using the FIRB appoach, so have no LGD and EAD models for capital purposes.

Retail exposures use EAD models, where the general approach is to estimate the proportion of the unused credit facility that will be further drawn down prior to default and add this to the current balance. This is material for revolving credit facilities, but generally not material for term products.

Retail LGD models are built using statistical models based on key drivers of loss. The LGD calculated to determine regulatory capital is based on an economic downturn. For portfolios with security (residential property and vehicles), components include probability of repossession and loss severity; For portfolios of an unsecured nature, components include probability of paying back a proportion of the debt and severity of loss.

Data history

The Group always seeks to use the longest history of available representative data 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

– Loans models are built on data dating back to 2002

– Overdraft models are built on data dating back to 2002

– Unquoted companies model is built on data dating back to 2002

– Publicly Quoted companies model is built on data dating back to 2004

– PELF model uses data dating back to 2008

– UK Motor Finance (Retail) model uses data back to 2002

– UK Motor Finance (Commercial) model uses data back to 2008

When default volumes are sufficient, the Group's PD models are built using logistic regression. Where historical default volumes are low, alternative approaches are used; in the case of the publicly quoted model, a ratings replication approach has been taken, while the PELF model is designed to align to the rank-order assessment of default risk by portfolio experts, thus providing consistency in rating assessments. Low default calibration methods are used as appropriate to ensure that the Group does not erroneously underestimate risk due to low volumes of default data.

INTERNAL DEVELOPMENT AND MONITORING OF IRB MODELS

Model development, validation and review

Risk models (including all IRB models), and subsequent changes, are generally developed by the relevant business area modelling teams on behalf of the business area. The models are challenged, both technically and from a business usage perspective, by an independent 'second line' unit (Risk Model Approval Team) 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 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). The chair of MGC has delegated approval responsibility from GRC. MGC attendees include senior risk and business model owners responsible for the model under consideration. All new IRB models and all material model changes are subject to governance in line with regulatory guidance from the EBA and PRA.

Once a model has been approved, it is subject to ongoing monitoring and Periodic Validation requirements. The Periodic Validation of models is undertaken by the business area modelling teams and is subject to the same governance process as a new model build. Periodic Validations are undertaken on an annual basis for all IRB models.

A hierarchy of model monitoring exists for all IRB models – detailed regular technical risk model performance (including rank ordering and predictive accuracy) is used to prioritise both model changes and corrective action for model underperformance. This is supplemented by more summarised half-yearly model monitoring to MGC. GRC is provided with an annual update on model performance. IRB model monitoring is also provided to the PRA on a quarterly basis.

In addition to a technical / statistical review of capital models, the Risk Model Approval Team also undertakes a review of the controls and processes that are in place to support the production of capital figures. This focusses on three areas, namely data, implementation and usage of the model. The review frequency of this is linked to the materiality of the model and is stipulated within the Group Model Governance Policy. More frequent reviews can occur if there are material changes to the controls and processes.

Where required, typically where there is a data or model weakness, an appropriate margin of conservatism is included in the estimated value of risk parameters to ensure capital adequacy. 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 issue is remediated.

Pillar 1 Capital requirements: Credit risk continued

The Risk Model Approval Team maintains an inventory of all risk models, including IRB models. In a general sense, this serves to assist the wider model governance process. More specifically, the inventory provides the following: a schedule of models under development or awaiting periodic validation, a means of tracking corrective actions set by the Risk Model Approval Team, defines individual accountability for models and collates documentation relating to IRB models.

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, risk model performance is sufficient to ensure Pillar 1 capital requirements adequately reflect the Group's risk exposure.

Further information on model risk, including details on measurement, mitigation and monitoring can be found in the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts (page 156).

Relationships between risk management function and internal audit function

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

OTHER APPLICATION OF IRB MODEL OUTPUTS

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 to the credit approval process, though the precise nature differs between business areas. For retail exposures, operational, application and behavioural scorecards (primarily used to make retail credit approval and account management decisions) are used as inputs to PD models. 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 in the business to allow for risk-adjusted pricing.

Calculating impairment: The calculation of provision 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.

Stress Testing: IRB model outputs are used in the various internal and regulatory stress testing exercises.

MODEL PERFORMANCE

This section splits into two parts. The first section provides an analysis of the performance of IRB models over the period 2015-2017. The second section focusses on the backtesting of the Group's most material PD models.

Summary performance of IRB models

The scope of this section includes all models using an RIRB or FIRB approach. In terms of risk metrics, the results show 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 exposures at the start of the period and compare the default level experienced during the year to the default level predicted by the Group's IRB models at the start of the period.

The calculations for LGD consider the set of exposures that have defaulted during the year and compare the loss level experienced on these accounts with the amounts predicted by the Group's IRB 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.

The calculation of the EAD ratio considers the set of defaulted accounts during the relevant period and compares the realised EAD for these exposures with the amounts predicted by the Group's IRB 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 100%.

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 the experience during a given year, 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 the current position in the economic cycle. In addition differences between actuals and predictions will arise due to changes in circumstances over the course of the 12-month period, e.g. credit policy or operational process changes.
- PD models are built on an 'obligor-weighted' (rather than 'EAD weighted') basis meaning that comparisons across portfolios can be skewed. Hence the data can be impacted by small numbers of defaulted counterparties with relatively larger EAD values. This has been observed in a few portfolios over time.
- Changes in portfolio composition and client exposure 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.

Pillar 1 Capital requirements: Credit risk continued

MODEL PERFORMANCE DATA

Corporates exposures in the tables below include SME and exclude specialised lending.

Table 15: Model performance[1]

2017 IRB Exposure Class	Probability of default Predicted Dec 16 %	Probability of default Actual Dec 17 %	Loss given default of defaulted assets Predicted Dec 16 %	Loss given default of defaulted assets Actual Dec 17 %	EAD of defaulted assets Ratio of predicted to actual %
Central governments or central banks	0.06%	0.00%			
Institutions	0.12%	0.40%			
Corporates	0.71%	0.76%			
Retail – mortgage total	1.33%	0.66%	13.48%	6.16%	103%
Retail – SME	2.70%	2.34%	80.05%	73.94%	105%
Retail – Qualifying revolving	1.58%	1.34%	79.09%	63.00%	107%
Retail – Other (non-SME)	2.51%	2.63%	63.43%	53.47%	114%

2016 IRB Exposure Class	Probability of default Predicted Dec 15 %	Probability of default Actual Dec 16 %	Loss given default of defaulted assets Predicted Dec 15 %	Loss given default of defaulted assets Actual Dec 16 %	EAD of defaulted assets Ratio of predicted to actual %
Central governments or central banks	0.05%	0.00%			
Institutions	0.21%	0.35%			
Corporates	0.69%	0.84%			
Retail – mortgage total	1.36%	0.77%	13.71%	4.86%	103%
Retail – SME	2.79%	1.67%	78.27%	72.61%	102%
Retail – Qualifying revolving	1.63%	1.31%	80.44%	60.10%	109%
Retail – Other (non-SME)	2.65%	2.31%	70.01%	56.68%	111%

2015 IRB Exposure Class	Probability of default Predicted Dec 14 %	Probability of default Actual Dec 15 %	Loss given default of defaulted assets Predicted Dec 14 %	Loss given default of defaulted assets Actual Dec 15 %	EAD of defaulted assets Ratio of predicted to actual %
Central governments or central banks	0.02%	0.00%			
Institutions	0.17%	0.00%			
Corporates	0.82%	0.70%			
Retail – mortgage total	1.48%	0.86%	13.98%	5.46%	103%
Retail – SME	3.20%	2.01%	68.19%	60.06%	101%
Retail – Qualifying revolving	1.96%	1.45%	80.26%	63.80%	112%
Retail – Other (non-SME)	3.26%	2.46%	74.74%	62.29%	110%

1 Retail results are all based on the 12 months ending November. Commercial Banking results for 2017 are based on the 12 months ending September. For previous years they are based on a 12-month period ending December.

Key observations

Corporate:

- Predicted versus actual default rates show mixed movements across the portfolios in 2017.
- Single name exposures drive PD under-predictions in the Institutions and Corporate asset classes. On an obligor-weighted basis, the Corporate and Institutions asset class predictions exceed actual default rates. For Institutions, the same obligor has provided the only default in both 2016 and 2017. The default occurred in late 2016 and therefore is included into both years following the change in reporting period.

Retail:

- Predicted default rates are greater than actual default rates for all asset classes except Retail – Other (non-SME), which has seen an increase in voluntary terminations on the UK Motor Finance (Retail) element of the book, comprising roughly half of the total Retail - Other (non-SME) EAD.
- Predicted LGDs exceed actual LGDs for all four asset classes.
- For Retail – Other (non-SME), the predicted and actual LGDs have fallen due to the increasing proportion of UK Motor Finance (Retail), where the LGDs are materially lower than for Loans due to its asset-backed structure. The implementation of a new PRA approved Lloyds Loans LGD model has also led to a reduction in predicted LGD.
- For Retail – Qualifying revolving, similarly to Retail – Other (non-SME), the implementation of an improved LGD model for Lloyds Bank Credit Cards and Overdrafts rating systems during 2017 has led to a reduction in predicted LGD.

Pillar 1 Capital requirements: Credit risk continued

Backtesting of PD models

This section focusses on the backtesting of PD models. The information in the following tables is based on the key significant rating systems noted earlier in this section with the exception of PELF and Quasi State. Both of these have risk-weighted-assets slightly above the threshold of £2.5bn, but rarely any defaults, hence their inclusion in backtesting tables would have limited value. The 'Corporate model' figures reported in this section are therefore a subset of Tables 26 and 27.

In line with EBA guidance this information is aggregated to Basel asset class, with exposures assessed under RIRB and FIRB shown in separate tables.

All tables follow the same format and adopt the following definitions:

- The PD ranges match those in the respective retail and commercial internal master scales.
- The external rating equivalent is the equivalent S&P rating described on page 36.
- The weighted average PD is calculated using the regulatory PD (within that risk grade) at the start of the period. The weighting is based on the EAD at the start of the period.
- The arithmetic average PD is calculated using the regulatory PD at the start of the period. This PD is volume weighted.
- The number of obligors is shown at the beginning and end of the period. This represents the full book position at both points, with new obligors (opened during the period) included in the end of year position (if still on book). Obligors that left during the year are not included in the end of year position. Various definitions of obligor operate within the bank, reflecting how the exposures are managed within each area. This translates as follows:
  - **Cards Loans and Overdrafts** aggregate at customer level within brand and product (an obligor's accounts are aggregated if they share the same brand and product).
  - **Mortgages** and **UK Motor Finance (Retail)** treat each account as a unique obligor. An obligor with two accounts would have two PDs.
  - The **Commercial Banking** and **UK Motor Finance (Commercial)** definition is legal entity by source system (obligors reside on different source systems according to the nature of the lending). This means that one legal entity might be represented by one or more obligors in the data if that entity has borrowing across one or more businesses (source systems). Furthermore, obligors that are 'connected' may share the same PD subject to certain conditions, although in the backtesting tables they may be reported as individual obligors (note that this differs to Tables 26 and 27 which performs an aggregation of obligors connected in this way).
- The number of defaults during the year is the total number of non-defaulted obligors at the start of the year that subsequently defaulted at any point in the following 12 months. The allocation to a risk grade is based on the PIT PD at the start of the year for Retail rating systems and regulatory PD for Commercial Banking rating systems. Exposures opened during the year are not included.
- 'Defaulted obligors – new exposures' relates to obligors that opened during the year and subsequently defaulted. Only one figure is provided within this column and this is assigned to the row 'New to Book'. This figure is currently unavailable for the Corporate SME and Corporate Main tables.
- The average default rate is calculated as a simple (volume weighted) average of five annual default rates. As some models were implemented less than five years ago and in a desire for broad consistency in the mix of obligors within the asset class, some tables are based on four years rather than five years of data.

For each table, a risk-weighted-asset coverage per cent is shown. This represents the proportion of the total (not in default) IRB risk-weighted assets within that Basel asset class that is covered by the backtesting analysis. For example, a figure of 95% would indicate that 5% of the IRB risk-weighted assets for that Basel asset class has not been included – the 5% would relate to rating systems not classed as significant.

The primary benefit of these tables is that they enable a comparison of predicted PD with actual default rate over both the short-term (12 months and the medium-term four to five years). When making this comparison, care needs to be taken with the interpretation as the result is partially dependent on the choice of PD approach (PIT or TTC).

As the PD backtesting tables have to be collated at Basel asset class level, the link between the Basel asset class and key rating systems has been summarised in the following table. All rating systems are for UK exposures only with the exception of Ireland Mortgages and Publicly Quoted which is a global rating system.

Basel Asset Class	Rating Systems Included
Corporate Main	Publicly Quoted, Unquoted, UK Motor Finance (Commercial)
Corporate SME	Unquoted, Publicly Quoted, BDCS
Retail – Mortgages (UK)	HBOS Mainstream mortgages, Lloyds Bank mortgages, HBOS Buy-to-Let mortgages, Other mortgages, BDCS
Retail – Mortgages (non-UK)	BOS Ireland mortgages
Retail – SME	Other mortgages, BDCS
Retail – Qualifying revolving	HBOS and Lloyds Bank Credit Cards, HBOS and Lloyds Bank Overdrafts
Retail – Other (non-SME)	HBOS and Lloyds Personal Loans and UK Motor Finance (Retail)

The identified significant rating systems provide only a very small volume of obligors to Institutions and Central Governments or Banks and hence no backtesting results are shown for these Basel asset classes.

The following is a list of pre-notifications sent to the PRA over the period of the 2017 backtesting. Pre-notifications represent material changes to rating systems and require PRA approval before they can be implemented. The list is restricted to the significant rating systems listed in the preceding table. Some of these changes have impacts on the backtesting and this has been reflected in the commentaries.

- A revised definition of default for all rating systems in Retail – Mortgages (UK) (except BDCS), with accompanying recalibrations of the associated PD models.
- A new PD model for the HBOS and Lloyds Bank Loans, Credit Cards and Overdrafts rating systems (this change required ex-ante notification; this means that the model is implemented two months after notification is sent to the PRA unless the regulator requests otherwise. It is included in this list as the impact on grade distribution is evident in this disclosure).
- New PIT and Downturn LGD models for all rating systems in Retail – Mortgages (UK) (except BDCS).
- New PIT and Downturn LGD models for Lloyds Bank Cards, Lloyds Bank Loans and Lloyds Bank Overdrafts rating systems.
- A reduction in scope of the Unquoted model following the introduction of the Quasi State model.

Pillar 1 Capital requirements: Credit risk continued

In the following backtesting tables the results are based on the significant rating systems shown in the table on page 41. Against each table we show the RWA coverage (risk-weighted assets within the table as a proportion of total IRB risk-weighted assets for that asset class). As these tables are based on key rating systems only, the number of obligors may not reconcile fully with figures shown elsewhere in this document. In some instances the volumes at 2016 year end do not align to the 2017 starting position and where this occurs, an explanation is provided.

Table 16: Back-testing of PD per portfolio – Retail – Mortgages (UK) (CR9)

RWA coverage: 95-99%

2017

			Number of obligors				
PD Range	Weighted average PD	Arithmetic average PD by obligors	End of previous year	End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	0.20%	0.18%	2,080,331	1,974,582	837	N/a	0.05%
0.10 - 0.40%	0.73%	0.70%	547,808	567,800	1,238	N/a	0.18%
0.40 - 0.80%	1.51%	1.60%	106,642	113,930	656	N/a	0.56%
0.80 - 1.20%	2.33%	2.55%	34,229	29,225	361	N/a	0.94%
1.20 - 2.50%	5.57%	5.71%	45,829	40,262	681	N/a	1.63%
2.50 - 4.50%	8.40%	8.95%	27,031	25,934	880	N/a	2.95%
4.40 - 7.50%	13.46%	14.27%	17,209	15,986	986	N/a	4.81%
7.50 - 10.00%	20.98%	21.59%	6,788	6,841	682	N/a	7.85%
10.00 - 14.00%	21.84%	22.75%	9,001	7,542	829	N/a	9.25%
14.00 - 20.00%	31.94%	33.22%	6,311	4,728	1,177	N/a	15.72%
20.00 - 30.00%	45.11%	46.02%	5,595	5,352	1,412	N/a	24.22%
30.00 - 45.00%	55.86%	57.78%	5,983	5,330	2,252	N/a	35.84%
45.00 -99.99%	76.97%	77.85%	7,028	6,269	4,456	N/a	57.27%
In Default	100.00%	100.00%	30,069	29,440	N/a	N/a	N/a
New to Book	N/a	N/a	–	244,445	N/a	9	N/a

2016

			Number of obligors				
PD Range	Weighted average PD	Arithmetic average PD by obligors	End of previous year	End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	0.21%	0.18%	1,621,780	1,758,967	546	N/a	0.07%
0.10 - 0.40%	0.55%	0.53%	1,020,545	809,952	1,769	N/a	0.25%
0.40 - 0.80%	1.30%	1.35%	168,205	150,359	1,007	N/a	0.60%
0.80 - 1.20%	2.07%	2.19%	51,920	38,058	546	N/a	0.96%
1.20 - 2.50%	4.50%	4.54%	65,217	54,080	1,106	N/a	1.63%
2.50 - 4.50%	7.42%	7.72%	35,963	28,675	1,309	N/a	2.78%
4.40 - 7.50%	11.90%	12.30%	20,922	17,993	1,283	N/a	4.59%
7.50 - 10.00%	17.15%	17.73%	8,690	7,322	803	N/a	7.31%
10.00 - 14.00%	19.25%	19.67%	8,971	7,528	963	N/a	9.27%
14.00 - 20.00%	30.25%	31.25%	8,981	6,189	1,746	N/a	14.52%
20.00 - 30.00%	42.46%	43.42%	5,299	5,395	1,681	N/a	22.82%
30.00 - 45.00%	52.53%	53.13%	5,571	5,986	2,323	N/a	34.17%
45.00 -99.99%	73.51%	73.92%	6,061	7,103	3,769	N/a	54.79%
In Default	100.00%	100.00%	32,217	31,567	N/a	N/a	N/a
New to Book	N/a	N/a	–	234,982	N/a	9	N/a

Key observations

– The majority of obligors are rated on a TTC basis which is conservative relative to the average historic observed default rates.

– Obligors are allocated to grades based on PIT PDs, so the weighted and arithmetic average PDs are above the range due to the use of more conservative TTC PDs.

– Following a change in the definition of default in 2017, the PD values at the start of 2017 have been adjusted to ensure consistency with the new definition. As a result, the distribution of obligors by PD grade at the start of 2017 does not align to the end 2016 position.

– The distribution of obligors by PD grade is broadly the same for the two year ends, with some movement across boundaries in lower risk grades.

Pillar 1 Capital requirements: Credit risk continued

Table 17: Back-testing of PD per portfolio – Retail QRRE (CR9)

RWA coverage: 100%

2017

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	**0.05%**	**0.05%**	**8,539,152**	**4,888,047**	**2,289**	**N/a**	**0.04%**
0.10 - 0.40%	**0.22%**	**0.23%**	**8,161,096**	**10,153,143**	**11,690**	**N/a**	**0.14%**
0.40 - 0.80%	**0.58%**	**0.59%**	**3,684,842**	**4,779,340**	**13,932**	**N/a**	**0.42%**
0.80 - 1.20%	**0.99%**	**0.99%**	**1,477,550**	**2,580,000**	**13,582**	**N/a**	**0.85%**
1.20 - 2.50%	**1.75%**	**1.76%**	**2,172,031**	**2,914,486**	**35,500**	**N/a**	**1.59%**
2.50 - 4.50%	**3.31%**	**3.33%**	**1,274,787**	**1,082,800**	**40,187**	**N/a**	**2.99%**
4.40 - 7.50%	**5.96%**	**5.87%**	**987,176**	**507,788**	**48,446**	**N/a**	**4.69%**
7.50 - 10.00%	**8.33%**	**8.27%**	**543,869**	**148,433**	**36,432**	**N/a**	**7.02%**
10.00 - 14.00%	**11.53%**	**11.59%**	**244,141**	**127,124**	**25,798**	**N/a**	**10.05%**
14.00 - 20.00%	**16.49%**	**16.55%**	**160,385**	**108,487**	**25,470**	**N/a**	**15.17%**
20.00 - 30.00%	**24.19%**	**24.23%**	**106,142**	**148,945**	**23,627**	**N/a**	**22.22%**
30.00 - 45.00%	**36.00%**	**36.14%**	**64,872**	**135,321**	**20,801**	**N/a**	**31.89%**
45.00 -99.99%	**65.78%**	**66.63%**	**74,086**	**89,763**	**40,609**	**N/a**	**57.06%**
In Default	**100.00%**	**100.00%**	**158,866**	**720,859**	**N/a**	**N/a**	**N/a**
New to Book	**N/a**	**N/a**	**–**	**2,452,369**	**N/a**	**28,076**	**N/a**

2016

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	0.05%	0.05%	8,200,723	8,539,152	1,964	N/a	0.05%
0.10 - 0.40%	0.22%	0.23%	8,702,313	8,161,096	11,985	N/a	0.14%
0.40 - 0.80%	0.57%	0.58%	2,822,852	3,684,842	12,031	N/a	0.43%
0.80 - 1.20%	0.99%	0.99%	1,429,456	1,477,550	11,786	N/a	0.83%
1.20 - 2.50%	1.75%	1.75%	2,178,348	2,172,031	32,211	N/a	1.58%
2.50 - 4.50%	3.33%	3.32%	1,331,550	1,274,787	37,647	N/a	2.95%
4.40 - 7.50%	6.05%	5.92%	1,019,615	987,176	46,260	N/a	4.64%
7.50 - 10.00%	8.31%	8.27%	519,359	543,869	32,944	N/a	7.10%
10.00 - 14.00%	11.47%	11.58%	239,606	244,141	24,966	N/a	9.92%
14.00 - 20.00%	16.40%	16.50%	160,829	160,385	24,584	N/a	14.99%
20.00 - 30.00%	24.17%	24.23%	106,813	106,142	24,180	N/a	22.21%
30.00 - 45.00%	36.18%	36.20%	62,172	64,872	20,860	N/a	31.85%
45.00 -99.99%	67.49%	69.40%	73,512	74,086	42,669	N/a	57.63%
In Default	100.00%	100.00%	195,794	158,866	N/a	N/a	N/a
New to Book	N/a	N/a	–	2,953,799	N/a	25,885	N/a

Key observations

– Average PDs are in excess of average default rates due to the presence of a PD buffer; all PD models are PIT.

– The implementation of an improved PD model in 2017 for HBOS and Lloyds Bank Credit Cards and HBOS and Lloyds Bank Overdrafts rating systems has resulted in some grade migration, particularly in the lowest risk grades.

– The scope of the improved LGD model that was implemented for Lloyds Bank Credit Cards and Lloyds Bank Overdrafts rating systems in 2017 now includes assets in recoveries leading to an increase in In Default obligors at the end of the year.

Pillar 1 Capital requirements: Credit risk continued

Table 18: Back-testing of PD per portfolio – Retail – Other (non-SME) (CR9)

RWA coverage: 100%

2017

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	0.08%	0.08%	24,078	20,130	25	N/a	0.09%
0.10 - 0.40%	0.36%	0.35%	374,386	391,087	2,471	N/a	0.51%
0.40 - 0.80%	0.68%	0.66%	306,420	340,260	2,579	N/a	0.67%
0.80 - 1.20%	1.01%	1.01%	178,697	180,100	1,471	N/a	0.77%
1.20 - 2.50%	1.69%	1.70%	531,827	570,727	8,892	N/a	1.45%
2.50 - 4.50%	3.29%	3.33%	226,051	246,621	7,920	N/a	2.79%
4.40 - 7.50%	5.88%	5.87%	104,236	108,829	7,094	N/a	5.37%
7.50 - 10.00%	8.62%	8.63%	24,785	23,532	2,390	N/a	7.72%
10.00 - 14.00%	11.22%	11.43%	28,060	22,436	3,476	N/a	10.06%
14.00 - 20.00%	17.99%	17.84%	21,063	8,373	2,424	N/a	11.96%
20.00 - 30.00%	22.03%	22.54%	14,419	13,376	2,857	N/a	17.92%
30.00 - 45.00%	34.87%	35.70%	14,289	16,202	4,493	N/a	31.18%
45.00 -99.99%	74.18%	74.57%	12,998	19,284	8,769	N/a	66.57%
In Default	100.00%	100.00%	24,905	126,671	N/a	N/a	N/a
New to Book	N/a	N/a	–	641,755	N/a	4,643	N/a

2016

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	0.08%	0.08%	19,840	24,986	15	N/a	0.09%
0.10 - 0.40%	0.35%	0.34%	262,955	377,085	1,209	N/a	0.48%
0.40 - 0.80%	0.68%	0.66%	298,353	307,152	1,985	N/a	0.62%
0.80 - 1.20%	1.00%	0.99%	166,120	178,697	1,203	N/a	0.76%
1.20 - 2.50%	1.69%	1.69%	565,751	533,164	7,562	N/a	1.39%
2.50 - 4.50%	3.29%	3.33%	237,548	226,393	6,580	N/a	2.61%
4.40 - 7.50%	5.86%	5.85%	111,805	104,397	5,987	N/a	5.01%
7.50 - 10.00%	8.56%	8.58%	26,365	24,785	2,103	N/a	7.24%
10.00 - 14.00%	11.08%	11.29%	27,749	28,114	2,765	N/a	9.47%
14.00 - 20.00%	17.88%	17.71%	15,730	21,063	1,650	N/a	12.07%
20.00 - 30.00%	21.80%	22.06%	12,436	14,465	2,120	N/a	17.44%
30.00 - 45.00%	35.07%	35.92%	12,271	14,316	3,957	N/a	31.12%
45.00 -99.99%	72.07%	72.17%	12,972	13,006	8,388	N/a	66.35%
In Default	100.00%	100.00%	24,314	24,944	N/a	N/a	N/a
New to Book	N/a	N/a	–	605,946	N/a	3,554	N/a

Key observations

– Average predicted default rates are greater than actual default rates for all bands except the two lowest risk grades. This is due to an increase in voluntary terminations on the UK Motor Finance (Retail) element of the book in these low risk grades.

– A small portion of the UK Motor Finance (Retail) book moved onto the standardised approach and is excluded from the 2017 table. As a result, there is a small difference between the end 2016 position and that at the start of 2017.

– The scope of the improved LGD model that was implemented for the Lloyds Bank loans rating system in 2017 includes assets in recoveries leading to an increase in In Default obligors at the end of the year.

Pillar 1 Capital requirements: Credit risk continued

Table 19: Back-testing of PD per portfolio – Retail SME (CR9)

RWA coverage: 100%

2017

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate[1]
			End of previous year	End of the year			
0.00 - 0.10%	**0.00%**	**0.00%**	**–**	**–**	**–**	**N/a**	**0.00%**
0.10 - 0.40%	**0.00%**	**0.00%**	**–**	**–**	**–**	**N/a**	**0.00%**
0.40 - 0.80%	**0.61%**	**0.59%**	**54,859**	**55,249**	**152**	**N/a**	**0.24%**
0.80 - 1.20%	**1.12%**	**1.12%**	**20,992**	**13,470**	**220**	**N/a**	**0.81%**
1.20 - 2.50%	**1.67%**	**1.67%**	**11,158**	**13,166**	**225**	**N/a**	**1.46%**
2.50 - 4.50%	**2.65%**	**2.62%**	**11,265**	**12,167**	**321**	**N/a**	**2.20%**
4.40 - 7.50%	**5.67%**	**5.67%**	**8,470**	**12,616**	**491**	**N/a**	**4.26%**
7.50 - 10.00%	**8.04%**	**8.04%**	**665**	**491**	**17**	**N/a**	**1.83%**
10.00 - 14.00%	**10.61%**	**10.66%**	**24,155**	**4,996**	**1,078**	**N/a**	**4.50%**
14.00 - 20.00%	**18.02%**	**18.02%**	**1,914**	**19,947**	**388**	**N/a**	**15.70%**
20.00 - 30.00%	**0.00%**	**0.00%**	**–**	**–**	**–**	**N/a**	**0.00%**
30.00 - 45.00%	**34.10%**	**34.10%**	**781**	**1,418**	**287**	**N/a**	**29.64%**
45.00 -99.99%	**78.18%**	**78.18%**	**1,090**	**1,964**	**310**	**N/a**	**29.56%**
In Default	**100.00%**	**100.00%**	**8,834**	**8,611**	**N/a**	**N/a**	**N/a**
New to Book	**N/a**	**N/a**	**N/a**	**N/a**	**N/a**	**N/a**	**N/a**

1 Default rates based on four years of data.

2 Covers BDCS only. Exposures have been transferred from Corporate RMS to Retail RMS which leads to some 'gaps' in the risk grades.

2016

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
			End of previous year	End of the year			
0.00 - 0.10%	0.00%	0.00%	–	–	–	N/a	0.00%
0.10 - 0.40%	0.00%	0.00%	–	–	–	N/a	0.00%
0.40 - 0.80%	0.61%	0.59%	54,238	55,108	137	N/a	0.22%
0.80 - 1.20%	1.12%	1.12%	21,482	13,523	160	N/a	0.73%
1.20 - 2.50%	1.67%	1.67%	11,196	12,840	141	N/a	1.27%
2.50 - 4.50%	2.62%	2.62%	11,436	11,867	259	N/a	1.98%
4.40 - 7.50%	5.67%	5.67%	8,673	12,176	346	N/a	3.75%
7.50 - 10.00%	8.04%	8.04%	714	576	10	N/a	1.59%
10.00 - 14.00%	10.61%	10.66%	24,692	4,937	888	N/a	4.51%
14.00 - 20.00%	18.02%	18.02%	2,143	20,193	345	N/a	14.18%
20.00 - 30.00%	0.00%	0.00%	–	–	–	N/a	0.00%
30.00 - 45.00%	34.10%	34.10%	971	1,375	272	N/a	27.27%
45.00 -99.99%	78.18%	78.18%	1,112	1,862	330	N/a	29.93%
In Default	100.00%	100.00%	8,770	8,796	N/a	N/a	N/a
New to Book	N/a	N/a	N/a	N/a	N/a	N/a	N/a

Key observations

- Default rates show some volatility due to low volumes in some risk grades. However, in all cases the average historical default rate is conservative when compared to the associated risk grade.
- Average historical defaults rates have shown small increases in most grades.
- Changes to the rating grade distribution in 2017 are driven by changes to the BDCS PD model.
- The numbers of obligors at the end of 2016 and the start of 2017 do not align due to the change in reporting period, as described in footnote under Table 15.

Pillar 1 Capital requirements: Credit risk continued

Table 20: Back-testing of PD per portfolio – Retail Mortgages (non-UK) (CR9)

RWA coverage: 100%

2017

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	**0.09%**	**0.09%**	**10**	**24**	**–**	**N/a**	**0.00%**
0.10 - 0.40%	**0.32%**	**0.33%**	**1,282**	**1,469**	**6**	**N/a**	**0.09%**
0.40 - 0.80%	**0.62%**	**0.59%**	**5,052**	**5,569**	**49**	**N/a**	**0.77%**
0.80 - 1.20%	**1.00%**	**1.00%**	**4,939**	**4,618**	**55**	**N/a**	**0.90%**
1.20 - 2.50%	**1.75%**	**1.70%**	**4,356**	**4,088**	**75**	**N/a**	**1.27%**
2.50 - 4.50%	**3.32%**	**3.25%**	**1,767**	**1,213**	**37**	**N/a**	**1.75%**
4.40 - 7.50%	**5.50%**	**5.67%**	**534**	**363**	**15**	**N/a**	**2.85%**
7.50 - 10.00%	**8.69%**	**8.61%**	**193**	**109**	**14**	**N/a**	**5.12%**
10.00 - 14.00%	**11.82%**	**11.80%**	**184**	**107**	**15**	**N/a**	**5.75%**
14.00 - 20.00%	**16.67%**	**16.69%**	**125**	**118**	**13**	**N/a**	**9.33%**
20.00 - 30.00%	**24.77%**	**24.91%**	**157**	**110**	**17**	**N/a**	**11.57%**
30.00 - 45.00%	**36.72%**	**36.25%**	**86**	**88**	**20**	**N/a**	**19.71%**
45.00 -99.99%	**54.75%**	**55.10%**	**130**	**27**	**57**	**N/a**	**42.41%**
In Default	**100.00%**	**100.00%**	**773**	**896**	**N/a**	**N/a**	**100.00%**
New to Book	**N/a**	**N/a**	**N/a**	**N/a**	**N/a**	**N/a**	**N/a**

2016

PD Range	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.10%	0.00%	0.00%	–	–	–	N/a	0.00%
0.10 - 0.40%	0.32%	0.33%	470	1,281	–	N/a	0.00%
0.40 - 0.80%	0.63%	0.61%	4,060	5,042	33	N/a	0.76%
0.80 - 1.20%	1.01%	1.00%	3,893	4,935	27	N/a	0.95%
1.20 - 2.50%	1.70%	1.66%	6,704	4,351	95	N/a	1.13%
2.50 - 4.50%	3.31%	3.24%	2,378	1,765	39	N/a	1.72%
4.40 - 7.50%	5.63%	5.73%	826	533	26	N/a	2.76%
7.50 - 10.00%	8.66%	8.67%	282	192	19	N/a	4.49%
10.00 - 14.00%	11.66%	11.82%	228	184	16	N/a	5.32%
14.00 - 20.00%	16.40%	16.42%	189	125	24	N/a	9.46%
20.00 - 30.00%	24.64%	24.66%	166	157	19	N/a	12.02%
30.00 - 45.00%	36.34%	35.54%	113	86	28	N/a	22.04%
45.00 -99.99%	57.28%	56.94%	154	130	78	N/a	44.76%
In Default	100.00%	100.00%	782	797	N/a	N/a	100.00%
New to Book	N/a	N/a	–	–	N/a	–	N/a

Key observations

– Average PDs are generally in excess of average default rates due to the presence of a PD buffer on the model.

Pillar 1 Capital requirements: Credit risk continued

Table 21: Back-testing of PD per portfolio – Corporate Main (CR9)[2]

RWA coverage: 65-70%

2017

PD Range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate[1]
0.00 - 0.035%	AAA to AA-	0.03%	0.03%	255	225	–	N/a	0.22%
0.035 - 0.050%	A+	0.04%	0.05%	509	461	–	N/a	0.00%
0.050 - 0.080%	A	0.06%	0.06%	113	124	–	N/a	0.00%
0.080 - 0.140%	A-	0.11%	0.11%	461	520	–	N/a	0.11%
0.140 - 0.220%	BBB+	0.18%	0.19%	1,136	1,253	1	N/a	0.09%
0.220 - 0.340%	BBB	0.28%	0.28%	1,049	1,339	2	N/a	0.14%
0.340 - 0.500%	BBB-	0.42%	0.43%	2,844	2,809	5	N/a	0.29%
0.500 - 0.760%	BB+	0.63%	0.66%	3,018	3,065	18	N/a	0.58%
0.760 - 1.240%	BB	1.01%	1.00%	2,652	2,736	16	N/a	0.59%
1.240 - 2.000%	BB-	1.62%	1.61%	2,042	1,878	26	N/a	1.27%
2.000 - 3.200%	B+	2.60%	2.59%	525	559	10	N/a	2.76%
3.200 - 5.200%	B+	3.99%	3.81%	1,236	1,131	27	N/a	1.78%
5.200 - 7.200%	B	6.20%	6.17%	197	248	16	N/a	4.58%
7.200 - 10.200%	B-	8.71%	8.75%	86	98	7	N/a	3.41%
10.200 - 13.800%	B-	11.97%	11.54%	56	74	7	N/a	7.82%
13.800 - 99.99%	CCC to C	29.52%	26.76%	104	184	19	N/a	10.83%
In Default	Default	100.00%	100.00%	468	440	N/a	N/a	N/a
New to Book	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a

1 Default rates based on 4 years of data.

2 Covers Publicly Quoted, Unquoted and UK Motor Finance (Commercial) with very little contribution from BDCS.

2016

PD Range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.035%	AAA to AA-	0.03%	0.03%	265	263	–	N/a	0.29%
0.035 - 0.050%	A+	0.04%	0.05%	569	521	–	N/a	0.00%
0.050 - 0.080%	A	0.06%	0.06%	149	133	–	N/a	0.00%
0.080 - 0.140%	A-	0.11%	0.11%	473	505	–	N/a	0.14%
0.140 - 0.220%	BBB+	0.18%	0.19%	1,293	1,241	1	N/a	0.09%
0.220 - 0.340%	BBB	0.28%	0.28%	1,111	1,214	2	N/a	0.12%
0.340 - 0.500%	BBB-	0.42%	0.43%	3,117	2,975	6	N/a	0.32%
0.500 - 0.760%	BB+	0.63%	0.64%	2,841	3,335	13	N/a	0.58%
0.760 - 1.240%	BB	1.00%	1.00%	2,695	2,866	14	N/a	0.58%
1.240 - 2.000%	BB-	1.62%	1.61%	1,881	2,168	19	N/a	1.27%
2.000 - 3.200%	B+	2.60%	2.60%	632	654	23	N/a	3.04%
3.200 - 5.200%	B+	4.12%	3.82%	1,106	1,298	30	N/a	1.64%
5.200 - 7.200%	B	6.20%	6.15%	125	289	5	N/a	3.39%
7.200 - 10.200%	B-	8.70%	8.79%	57	102	2	N/a	1.84%
10.200 - 13.800%	B-	11.99%	11.61%	46	74	6	N/a	6.27%
13.800 - 99.99%	CCC to C	25.23%	25.27%	93	142	8	N/a	8.35%
In Default	Default	100.00%	100.00%	533	480	N/a	N/a	N/a
New to Book	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a

Key observations

- Relatively low default volumes lead to year-to-year volatility in default rates within a given PD range.
- The distribution of obligors by PD grade is similar for the two year ends.
- The numbers of obligors at the end of 2016 and the start of 2017 do not align due to the change in reporting period, as described in footnote under Table 15.
- The total number of obligors at the end of 2017 does not align with that in Table 26 due to the difference in reporting period and because this table is based on significant rating systems only.

Pillar 1 Capital requirements: Credit risk continued

Table 22: Back-testing of PD per portfolio – Corporate SME (CR9)[2]

RWA coverage: 75-80%

2017

PD Range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate[1]
0.00 - 0.035%	AAA to AA-	0.03%	0.03%	12	6	–	N/a	0.00%
0.035 - 0.050%	A+	0.04%	0.04%	4	1	–	N/a	0.00%
0.050 - 0.080%	A	0.06%	0.06%	222	214	–	N/a	0.00%
0.080 - 0.140%	A-	0.11%	0.11%	1,693	1,624	–	N/a	0.08%
0.140 - 0.220%	BBB+	0.18%	0.18%	633	362	–	N/a	0.05%
0.220 - 0.340%	BBB	0.28%	0.28%	703	964	1	N/a	0.47%
0.340 - 0.500%	BBB-	0.42%	0.42%	618	386	–	N/a	0.25%
0.500 - 0.760%	BB+	0.63%	0.62%	3,371	3,961	13	N/a	0.47%
0.760 - 1.240%	BB	1.08%	1.09%	2,510	1,959	18	N/a	1.03%
1.240 - 2.000%	BB-	1.65%	1.66%	1,393	1,563	13	N/a	0.95%
2.000 - 3.200%	B+	2.61%	2.62%	1,255	1,215	16	N/a	2.44%
3.200 - 5.200%	B+	4.20%	4.20%	131	195	1	N/a	1.48%
5.200 - 7.200%	B	5.78%	5.75%	619	873	32	N/a	4.05%
7.200 - 10.200%	B-	8.21%	8.20%	204	149	3	N/a	1.92%
10.200 - 13.800%	B-	10.75%	10.70%	349	356	34	N/a	9.14%
13.800 - 99.99%	CCC to C	25.13%	26.87%	134	316	32	N/a	23.27%
In Default	Default	100.00%	100.00%	259	232	N/a	N/a	N/a
New to Book	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a

1 Default rates based on four years of data.

2 Covers BDCS and Unquoted with very little contribution from Publicly Quoted.

2016

PD Range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors: End of previous year	Number of obligors: End of the year	Defaulted obligors in the year	of which: new defaulted obligors in the year	Average historical annual default rate
0.00 - 0.035%	AAA to AA-	0.03%	0.03%	6	5	–	N/a	0.00%
0.035 - 0.050%	A+	0.04%	0.04%	4	2	–	N/a	0.00%
0.050 - 0.080%	A	0.06%	0.06%	228	215	–	N/a	0.00%
0.080 - 0.140%	A-	0.11%	0.11%	1,260	1,551	–	N/a	0.11%
0.140 - 0.220%	BBB+	0.18%	0.18%	851	613	–	N/a	0.06%
0.220 - 0.340%	BBB	0.28%	0.28%	650	640	2	N/a	0.58%
0.340 - 0.500%	BBB-	0.42%	0.42%	545	580	–	N/a	0.33%
0.500 - 0.760%	BB+	0.63%	0.62%	2,938	3,836	15	N/a	0.49%
0.760 - 1.240%	BB	1.07%	1.09%	2,006	1,941	17	N/a	1.14%
1.240 - 2.000%	BB-	1.65%	1.65%	1,205	1,546	13	N/a	0.95%
2.000 - 3.200%	B+	2.61%	2.61%	1,137	1,221	29	N/a	2.83%
3.200 - 5.200%	B+	4.20%	4.20%	140	221	2	N/a	1.72%
5.200 - 7.200%	B	5.99%	5.75%	489	789	22	N/a	3.68%
7.200 - 10.200%	B-	8.21%	8.25%	127	183	–	N/a	2.08%
10.200 - 13.800%	B-	10.67%	10.70%	277	230	24	N/a	8.94%
13.800 - 99.99%	CCC to C	27.44%	28.04%	128	271	24	N/a	23.07%
In Default	Default	100.00%	100.00%	320	251	N/a	N/a	N/a
New to Book	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a

Key observations

– Observed default rates generally rise through the PD ranges as expected. In most instances, actual default rates fall within or below the PD ranges.
– The low volume of defaults causes some fluctuation in average historic default rates but the default rates remain broadly aligned across the two years.
– The distribution of obligors by PD grade is similar for the two year ends.
– The numbers of obligors at the end of 2016 and the start of 2017 do not align due to the change in reporting period, as described in footnote under Table 15.
– The total number of obligors at the end of 2017 does not align with that in Table 27 due to the difference in reporting period, because this table is based on significant rating systems only, and due to a difference in how some obligors have been grouped.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES BY ASSET CLASS

CREDIT RISK EXPOSURES

The following tables show the Group's credit exposures split by Basel exposure class, together with associated risk-weighted assets and average risk weight. Exposures are presented are on a pre CRM and post CCF basis.

Table 23: Total and average net amount of exposures (CRB-B)

	2017				
	Credit risk exposure £m	Average credit risk exposure £m	Risk-weighted assets £m	Minimum capital requirements £m	Average risk weight %
Central governments or central banks	17,722	16,550	1,416	113	8%
Institutions	4,173	4,912	1,087	87	26%
Corporates	103,708	105,373	57,703	4,616	56%
of which: Specialised lending	16,596	17,474	11,965	957	72%
of which: SMEs	11,662	11,762	7,608	609	65%
Retail	394,687	393,507	61,588	4,927	16%
Secured by real estate property	334,359	334,934	36,763	2,941	11%
SMEs	9,769	9,991	2,554	204	26%
Non-SMEs	324,590	324,943	34,209	2,737	11%
Qualifying revolving	40,285	39,179	11,142	891	28%
Other retail	20,043	19,394	13,684	1,095	68%
SMEs	2,200	2,320	1,578	126	72%
Non-SMEs	17,843	17,074	12,106	968	68%
Equity	3,355	3,479	7,381	591	220%
Non-credit obligation assets[1]	10,208	10,454	5,866	469	57%
Total IRB approach	533,852	534,275	135,042	10,803	25%
Central governments or central banks	76,438	79,632	8	1	–
Regional governments or local authorities	5	2	1	–	20%
Public sector entities	21	9	21	2	100%
Multilateral development banks	1,837	1,834	–	–	–
International organisations	–	–	–	–	–
Institutions	189	264	32	3	17%
Corporates	12,724	12,854	10,902	872	86%
of which: SMEs	3,209	3,199	2,927	234	91%
Retail	12,819	9,276	9,256	740	72%
of which: SMEs	2,144	2,054	1,250	100	58%
Secured by mortgages on immovable property	5,153	5,327	1,944	156	38%
of which: SMEs	14	8	7	1	49%
Exposures in default	681	755	765	61	112%
Items associated with particularly high risk	–	–	–	–	–
Covered bonds	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–
Collective investments undertakings	278	244	56	4	20%
Equity exposures	–	–	–	–	–
Other exposures[1]	3,114	3,313	2,273	182	73%
Total standardised approach	113,259	113,511	25,259	2,021	22%
Total	647,111	647,787	160,301	12,824	25%

Pillar 1 Capital requirements: Credit risk continued

2016	Credit risk exposure £m	Average credit risk exposure £m	Risk-weighted assets £m	Minimum capital requirements £m	Average risk weight %
Central governments or central banks	15,153	17,597	1,430	114	9%
Institutions	6,011	6,861	957	77	16%
Corporates	109,324	112,518	62,519	5,002	57%
of which: Specialised lending	18,816	19,681	13,469	1,077	72%
of which: SMEs	11,981	12,777	7,880	630	66%
Retail	390,965	392,942	64,970	5,198	17%
Secured by real estate property	335,510	338,097	39,550	3,164	12%
SMEs	10,211	10,393	2,662	213	26%
Non-SMEs	325,299	327,704	36,888	2,951	11%
Qualifying revolving	36,984	37,059	12,073	966	33%
Other retail	18,471	17,786	13,347	1,068	72%
SMEs	2,445	2,506	1,728	138	71%
Non-SMEs	16,026	15,280	11,618	930	72%
Equity	3,426	4,085	7,659	613	224%
Non-credit obligation assets[1]	10,890	9,639	6,427	514	59%
Total IRB approach	535,769	543,642	143,962	11,517	27%
Central governments or central banks	81,021	91,330	–	–	–
Regional governments or local authorities	–	1	–	–	–
Public sector entities	2	2	2	–	100%
Multilateral development banks	1,753	1,412	–	–	–
International organisations	–	–	–	–	–
Institutions	279	193	117	9	42%
Corporates	13,511	14,202	10,801	864	80%
of which: SMEs	3,187	3,881	2,938	235	92%
Retail	4,114	4,546	2,761	221	67%
of which: SMEs	1,967	2,591	1,150	92	58%
Secured by mortgages on immovable property	5,504	5,703	1,981	159	36%
of which: SMEs	8	28	4	–	52%
Exposures in default	789	916	883	71	112%
Items associated with particularly high risk	–	–	–	–	–
Covered bonds	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–
Collective investments undertakings	224	45	45	4	20%
Equity exposures	–	–	–	–	–
Other exposures[1]	3,091	3,372	2,098	168	68%
Total standardised approach	110,288	121,722	18,688	1,496	17%
Total	646,057	665,364	162,650	13,013	25%

1 Non-credit obligation assets (IRB approach) and other exposures (Standardised approach) predominantly relate to other balance sheet assets that have no associated credit risk. These comprise previous non-financial assets, including fixed assets, cash, items in the course of collection, prepayments and sundry debtors.

Pillar 1 Capital requirements: Credit risk continued

Exposures subject to the IRB approach – key movements

Central governments or central banks

– Exposures increased by £2.6bn mainly due to the increase in deposits placed with US Federal Reserve partially offset by foreign exchange revaluation.

Institutions

– Exposures decreased by £1.8bn mainly driven by the sale of covered bonds.

Corporates

– Exposures and risk-weighted assets decreased by £5.6bn and £4.8bn respectively mainly due to continued active portfolio management, including securitisation activity, partially offset by targeted growth in key customer segments.

Retail – Secured by real estate property

– Exposures decreased by £1.1bn to £334.4bn reflecting the Group's continued focus on balancing margin and risk considerations with volume growth. Risk-weighted assets and average risk weight decreased by £2.8bn and 1% respectively mainly due to PRA approved model changes.

Retail – Qualifying revolving

– Exposures increased by £3.3bn with a reduction in risk-weighted assets of £0.9bn. The increase in credit risk exposures is due to model calibrations, the risk-weighted asset impact of this is offset by the implementation of PRA approved model changes, which resulted in a reduction in risk-weighted assets and average risk weight of 5%.

Retail – Other (non-SME)

– Exposures and risk-weighted assets increased by £1.8bn and £0.5bn respectively with average risk weight reduction of 4% due to growth in the UK Motor Finance business, where LGDs are materially lower than for loans due to its asset-backed structure, and due to PRA approved model changes.

Exposures subject to the Standardised approach – key movements

Central governments or central banks

– Exposures decreased by £4.6bn mainly due to a reduction in UK Gilt holdings partially offset by cash deposits placed with Bank of England and De Nederlandsche Bank.

Corporates

– Exposures decreased by £0.8bn and risk-weighted assets increased by £0.1bn mainly due to continued portfolio management activity offset by an updated approach to charge-back exposure risk.

Retail

– Exposures and risk-weighted assets increased by £8.7bn and £6.5bn respectively due to the acquisition of MBNA, risk-weighted at 75%, increasing the average risk weight. Other exposures in this asset class benefit from the SME scalar.

Secured by mortgages on immovable property

– Exposures decreased by £0.4bn mainly due to repayments.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES SUBJECT TO THE FOUNDATION IRB APPROACH

This section provides a detailed analysis, by PD Grade, of credit risk exposures subject to the FIRB Approach. Exposures in the tables below are stated on two different bases (gross carrying values and EAD post-CCF and CRM). On-balance sheet gross exposures and off- balance sheet exposures represent gross carrying values (before taking into account SCRAs) before the application of CRM and CCF.

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

The EBA guidelines include a single prescribed scale for presenting the credit quality of all IRB portfolios by asset class. The tables that follow present the prescribed scale. This does not map directly to the internal scales per tables 13 and 14, but is apportioned on the same basis.

Throughout this section 'RWA density' represents the 'average risk weight'. 'Number of obligors' corresponds to the number of individual PDs (in each band). In the case of Corporate Main and Corporate SME, as customers may have exposures in both Commercial Banking and Motor Finance divisions, an individual corporate obligor may be counted twice.

Table 24: IRB – Credit risk exposures by portfolio and PD range – Central governments or central banks (CR6)

PD Scale Central governments or central banks	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 Average Maturity (years)	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m
0.00 to <0.15	17,722	–	–	17,722	0.01%	11	45.00%	2.5	1,416	7.99%	1	
0.15 to <0.25	–	–	–	–	–	–	–	–	–	–	–	
0.25 to <0.50	–	–	–	–	–	–	–	–	–	–	–	
0.50 to <0.75	–	–	–	–	–	–	–	–	–	–	–	
0.75 to <2.50	–	–	–	–	–	–	–	–	–	–	–	
2.50 to <10.00	–	–	–	–	–	–	–	–	–	–	–	
10.00 to <100.00	–	–	–	–	–	–	–	–	–	–	–	
100.00 (Default)	–	–	–	–	–	–	–	–	–	–	–	
Sub-total	17,722	–	–	17,722	0.01%	11	45.00%	2.5	1,416	7.99%	1	–

PD Scale Central governments or central banks	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 Average Maturity (years)	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m
0.00 to <0.15	15,153	–	–	15,153	0.01%	6	45.00%	3.0	1,430	9.44%	1	
0.15 to <0.25	–	–	–	–	–	–	–	–	–	–	–	
0.25 to <0.50	–	–	–	–	–	–	–	–	–	–	–	
0.50 to <0.75	–	–	–	–	–	–	–	–	–	–	–	
0.75 to <2.50	–	–	–	–	–	–	–	–	–	–	–	
2.50 to <10.00	–	–	–	–	–	–	–	–	–	–	–	
10.00 to <100.00	–	–	–	–	–	–	–	–	–	–	–	
100.00 (Default)	–	–	–	–	–	–	–	–	–	–	–	
Sub-total	15,153	–	–	15,153	0.01%	6	45.00%	3.0	1,430	9.44%	1	–

Key movements

– EAD post CRM and post CCF increased by £2.6bn to £17.7bn mainly due to the increase in deposits placed with US Federal Reserve partially offset by foreign exchange revaluation.

Pillar 1 Capital requirements: Credit risk continued

Table 25: IRB – Credit risk exposures by portfolio and PD range – Institutions (CR6)

PD Scale Institutions	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 Average Maturity (years)	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m
0.00 to <0.15	2,882	845	70.78%	4,256	0.05%	466	38.29%	1.6	681	16.01%	1	
0.15 to <0.25	95	326	50.79%	222	0.18%	54	39.34%	1.5	75	33.86%	–	
0.25 to <0.50	19	233	72.33%	177	0.29%	58	44.97%	1.7	86	48.60%	–	
0.50 to <0.75	128	17	68.80%	139	0.63%	33	45.00%	1.2	95	68.05%	–	
0.75 to <2.50	157	56	36.46%	178	1.01%	52	41.21%	0.6	149	83.72%	1	
2.50 to <10.00	1	–	–	1	3.07%	17	42.69%	1.3	1	139.55%	–	
10.00 to <100.00	–	–	–	–	–	7	–	–	–	–	–	
100.00 (Default)	28	–	–	28	100.00%	6	45.00%	1.2	–	–	13	
Sub-total	3,310	1,476	68.10%	5,001	0.68%	693	38.90%	1.6	1,087	21.74%	15	–

PD Scale Institutions	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 Average Maturity (years)	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m
0.00 to <0.15	3,668	1,873	74.08%	5,250	0.05%	375	22.18%	2.1	535	10.18%	1	
0.15 to <0.25	215	194	65.42%	365	0.18%	33	45.00%	1.2	130	35.64%	–	
0.25 to <0.50	211	264	76.52%	413	0.33%	63	44.84%	1.3	200	48.35%	1	
0.50 to <0.75	3	12	21.92%	5	0.62%	34	44.23%	1.4	4	85.13%	–	
0.75 to <2.50	80	54	35.16%	99	1.03%	49	38.98%	0.9	83	83.95%	–	
2.50 to <10.00	4	1	0.01%	4	3.89%	17	41.22%	1.3	5	144.91%	–	
10.00 to <100.00	–	–	–	–	–	6	–	–	–	–	–	
100.00 (Default)	42	–	–	42	100.00%	10	45.00%	1.6	–	–	19	
Sub-total	4,223	2,398	72.48%	6,178	0.78%	587	25.50%	2.0	957	15.50%	21	13

Key movements

– EAD post CRM post CCF decreased by £1.2bn to £5.0bn mainly driven by the sale of covered bonds.
– LGD has increased by 13.40% to 38.90% due to the sale of covered bonds which benefits from preferential LGD treatment, and the disposal of fully cash collateralised exposures with 0% LGD. This movement also contributed to a net increase of 6.24% in average risk-weight to 21.74%.

Pillar 1 Capital requirements: Credit risk continued

Table 26: IRB – Credit risk exposures by portfolio and PD range – Corporate Main (CR6)

PD Scale Corporate – Main	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 Average Maturity (years)	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m
0.00 to <0.15	16,820	19,291	74.99%	30,580	0.07%	2,100	42.45%	2.9	7,986	26.12%	10	
0.15 to <0.25	5,930	6,961	73.60%	10,573	0.18%	3,126	43.69%	2.0	4,004	37.87%	9	
0.25 to <0.50	10,591	10,016	71.56%	15,886	0.34%	5,866	43.48%	2.3	9,163	57.68%	25	
0.50 to <0.75	2,806	1,976	70.16%	4,034	0.63%	6,730	43.42%	2.1	3,030	75.12%	11	
0.75 to <2.50	6,092	4,636	70.02%	8,975	1.24%	11,254	43.48%	2.3	8,990	100.17%	54	
2.50 to <10.00	2,563	1,307	63.58%	3,264	3.99%	5,088	42.97%	2.3	4,552	139.45%	64	
10.00 to <100.00	102	109	71.52%	179	20.76%	652	44.19%	2.6	406	226.07%	14	
100.00 (Default)	864	177	71.29%	989	100.00%	756	43.05%	1.8	–	–	426	
Sub-total	45,769	44,474	72.90%	74,480	1.86%	35,573	43.06%	2.5	38,131	51.20%	611	567

PD Scale Corporate – Main	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 Average Maturity (years)	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m
0.00 to <0.15	16,090	18,757	76.18%	29,898	0.07%	2,191	42.13%	3.0	8,157	27.28%	8	
0.15 to <0.25	7,035	8,560	75.94%	13,528	0.18%	1,495	44.09%	2.1	5,407	39.97%	11	
0.25 to <0.50	9,632	11,516	71.36%	16,791	0.34%	4,490	43.75%	2.4	9,833	58.56%	25	
0.50 to <0.75	3,291	2,626	63.92%	4,751	0.63%	6,260	43.74%	2.5	3,781	79.58%	13	
0.75 to <2.50	6,735	4,053	68.40%	9,012	1.24%	14,235	43.35%	2.3	8,772	97.34%	49	
2.50 to <10.00	2,637	1,082	70.44%	3,273	4.29%	4,647	42.85%	2.4	4,592	140.32%	60	
10.00 to <100.00	172	138	68.11%	263	24.79%	599	44.49%	1.9	629	239.14%	29	
100.00 (Default)	793	110	65.55%	864	100.00%	857	42.89%	1.9	–	–	370	
Sub-total	46,385	46,842	73.41%	78,380	1.67%	34,774	43.10%	2.6	41,171	52.53%	565	488

Key movements

– EAD post CRM post CCF and risk-weighted assets decreased by £3.9bn and £3.0bn respectively mainly due to continued active portfolio management, partially offset by targeted growth in key customer segments.

Pillar 1 Capital requirements: Credit risk continued

Table 27: IRB – Credit risk exposures by portfolio and PD range – Corporate SME (CR6)

PD Scale Corporate – SME	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 Average Maturity (years)	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m
0.00 to <0.15	744	476	87.09%	1,172	0.07%	245	40.39%	3.2	253	21.56%	–	
0.15 to <0.25	244	391	74.97%	536	0.18%	324	43.26%	2.4	188	35.11%	–	
0.25 to <0.50	902	533	72.72%	1,282	0.36%	1,063	41.83%	2.2	668	52.10%	2	
0.50 to <0.75	1,311	371	70.87%	1,574	0.58%	3,573	37.93%	3.1	902	57.28%	4	
0.75 to <2.50	3,255	791	71.40%	3,813	1.24%	8,322	37.79%	2.9	2,700	70.79%	19	
2.50 to <10.00	2,223	441	78.19%	2,571	4.37%	5,077	38.06%	2.9	2,523	98.10%	43	
10.00 to <100.00	274	25	71.07%	291	17.75%	1,449	37.43%	2.5	375	128.76%	15	
100.00 (Default)	401	27	80.76%	423	100.00%	894	39.19%	2.0	–	–	166	
Sub-total	9,353	3,056	75.53%	11,662	5.57%	20,948	38.87%	2.8	7,608	65.23%	250	115

PD Scale Corporate – SME	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 Average Maturity (years)	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m
0.00 to <0.15	853	337	78.86%	1,127	0.08%	253	40.75%	3.5	311	27.61%	–	
0.15 to <0.25	179	206	73.35%	329	0.18%	206	43.31%	2.6	121	36.72%	–	
0.25 to <0.50	947	554	73.48%	1,339	0.37%	1,197	41.54%	2.1	616	45.97%	2	
0.50 to <0.75	1,364	294	69.84%	1,583	0.58%	3,464	37.97%	3.2	906	57.23%	4	
0.75 to <2.50	3,424	839	72.53%	4,012	1.23%	8,412	38.03%	2.9	2,849	71.03%	19	
2.50 to <10.00	2,382	406	74.71%	2,693	4.32%	5,044	37.91%	2.7	2,628	97.57%	44	
10.00 to <100.00	315	27	72.64%	335	20.66%	1,544	37.22%	2.6	449	133.95%	26	
100.00 (Default)	543	28	66.18%	563	100.00%	962	39.71%	2.1	–	–	224	
Sub-total	10,007	2,691	73.55%	11,981	6.79%	21,082	38.85%	2.8	7,880	65.77%	319	144

Key movements

– EAD post CRM and post CCF decreased by £0.3bn to £11.7bn and risk weighted assets decreased by £0.3bn to £7.6bn mainly due to active portfolio management, including securitisation activity.

– The decrease in average PD is mainly driven by a reduction in the proportion of defaulted exposures.

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. Exposures in the tables below are stated on two different bases (gross carrying values and EAD post-CCF and CRM). On-balance sheet gross exposures and off- balance sheet exposures represent gross carrying values (before taking into account SCRAs) before the application of CRM and CCF.

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.

The Basel guidelines include a single prescribed scale for presenting the credit quality of all IRB portfolios by asset class. The tables that follow present the prescribed scale. This does not map directly to the internal scales per tables 13 and 14, but is apportioned on the same basis.

Throughout this section 'RWA density' represents the 'average risk weight'.

'Number of obligors' corresponds to the number of individual PDs (in each band). This means that a customer may be counted more than once in the same asset class. In the case of Other Retail, for example, which includes both Motor Finance and Unsecured Personal Loans, a customer may have both of those products which would be reported as two separate obligors.

Table 28: IRB – Credit risk exposures by portfolio and PD range – Residential mortgages (SME) (CR6)

PD Scale Residential mortgages (SME)	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m	2017 Undrawn commitments (post CCF) £m
0.00 to <0.15	–	–	–	–	–	–	–	–	–	–		–
0.15 to <0.25	–	–	–	–	–	–	–	–	–	–		–
0.25 to <0.50	–	–	–	–	–	–	–	–	–	–		–
0.50 to <0.75	3,045	310	97.79%	3,349	0.54%	23,555	15.56%	377	11.25%	3		304
0.75 to <2.50	3,807	330	97.47%	4,128	1.13%	26,937	17.05%	824	19.97%	8		322
2.50 to <10.00	1,599	97	97.08%	1,694	4.25%	11,269	17.91%	779	45.99%	13		94
10.00 to <100.00	401	17	95.77%	417	21.59%	3,652	19.77%	348	83.33%	18		16
100.00 (Default)	177	3	98.01%	180	100.00%	1,632	10.52%	226	125.22%	19		3
Sub-total	**9,029**	**757**	**97.52%**	**9,769**	**4.17%**	**67,045**	**16.69%**	**2,554**	**26.14%**	**61**	**25**	**739**

PD Scale Residential mortgages (SME)	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m	2016 Undrawn commitments (post CCF) £m
0.00 to <0.15	–	–	–	–	–	–	–	–	–	–		–
0.15 to <0.25	–	–	–	–	–	–	–	–	–	–		–
0.25 to <0.50	–	–	–	–	–	–	–	–	–	–		–
0.50 to <0.75	3,154	327	97.94%	3,475	0.54%	24,378	16.01%	376	10.82%	3		321
0.75 to <2.50	3,983	322	97.45%	4,296	1.13%	26,873	17.45%	827	19.24%	9		313
2.50 to <10.00	1,621	89	96.81%	1,709	4.17%	11,333	18.23%	745	43.61%	13		87
10.00 to <100.00	481	19	96.47%	499	21.61%	4,006	19.11%	379	75.90%	21		18
100.00 (Default)	228	4	97.16%	232	100.00%	2,277	8.34%	335	144.48%	19		4
Sub-total	9,467	761	97.56%	10,211	4.68%	68,867	16.97%	2,662	26.07%	65	17	743

Pillar 1 Capital requirements: Credit risk continued

Table 29: IRB – Credit risk exposures by portfolio and PD range – Residential mortgages (non-SME) (CR6)

PD Scale Residential mortgages (non-SME)	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m	2017 Undrawn commitments (post CCF) £m
0.00 to <0.15	231,775	11,172	97.60%	254,252	0.26%	2,265,026	10.30%	13,936	5.48%	72		10,904
0.15 to <0.25	22,637	212	70.05%	23,872	0.76%	200,175	10.99%	2,802	11.74%	20		149
0.25 to <0.50	17,971	130	73.01%	18,933	1.17%	158,996	10.91%	2,954	15.60%	23		95
0.50 to <0.75	4,852	11	60.59%	5,085	2.15%	47,177	12.80%	1,329	26.13%	12		6
0.75 to <2.50	9,218	174	64.36%	9,698	4.15%	74,360	17.72%	4,382	45.18%	52		112
2.50 to <10.00	5,389	7	82.15%	5,603	13.24%	41,737	16.41%	4,175	74.52%	90		5
10.00 to <100.00	3,162	–	–	3,247	49.08%	27,129	12.31%	2,218	68.30%	179		–
100.00 (Default)	3,901	–	–	3,901	100.00%	28,273	14.41%	2,413	61.86%	445		–
Sub-total	298,905	11,707	96.28%	324,590	2.40%	2,842,873	10.82%	34,209	10.54%	893	1,540	11,272

PD Scale Residential mortgages (non-SME)	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m	2016 Undrawn commitments (post CCF) £m
0.00 to <0.15	210,668	10,358	96.82%	231,330	0.23%	2,140,658	9.94%	11,547	4.99%	58		10,028
0.15 to <0.25	30,428	314	58.20%	32,105	0.61%	281,254	10.41%	3,228	10.06%	21		183
0.25 to <0.50	25,396	183	59.61%	26,717	0.96%	227,202	11.33%	3,889	14.56%	29		109
0.50 to <0.75	7,345	26	56.57%	7,698	1.60%	67,819	12.70%	1,685	21.89%	15		15
0.75 to <2.50	12,066	491	24.81%	12,686	3.37%	102,578	16.67%	5,078	40.03%	58		122
2.50 to <10.00	6,350	4	58.68%	6,600	10.92%	50,120	15.75%	4,603	69.74%	94		2
10.00 to <100.00	3,777	–	–	3,877	45.53%	31,529	12.29%	2,739	70.65%	212		–
100.00 (Default)	4,286	–	–	4,286	100.00%	31,100	14.12%	4,119	96.09%	328		–
Sub-total	300,316	11,376	91.94%	325,299	2.56%	2,932,260	10.63%	36,888	11.34%	815	1,703	10,459

Key movements

– EAD post CRM and post CCF decreased by £0.7bn to £324.6bn reflecting the Group's continued focus on balancing margin and risk consideration with volume growth.

– Risk-weighted assets decreased by £2.7bn to £34.2bn mainly due to PRA approved model changes. There was also some grade migration arising from PRA approved change in the definition of default. Refer to Model Performance section on pages 37 to 48 for further details.

Pillar 1 Capital requirements: Credit risk continued

Table 30: Residential mortgage exposures by major portfolio

Exposures in the table below are presented are on a pre CRM and post CCF basis.

Major Portfolio	2017 Credit risk exposure £m	2017 Exposure weighted average PD %	2017 Exposure weighted average LGD[1] %	2017 Average risk weight %	2017 Undrawn commitments (pre CCF)[2] £m	2017 Undrawn commitments (post CCF) £m
UK mainstream	241,006	2.26%	9.83%	8.42%	9,587	9,441
UK buy-to-let	56,767	1.44%	12.10%	13.28%	1,498	1,498
UK self certified	14,737	7.16%	8.82%	10.63%	476	244
Irish mortgages	3,541	9.73%	41.92%	101.19%	–	–
Dutch mortgages	6,471	1.30%	23.27%	15.75%	146	87
Other mortgages	11,835	3.92%	15.96%	23.30%	758	739
Total	334,359	2.46%	10.99%	10.99%	12,464	12,009

Major Portfolio	2016 Credit risk exposure £m	2016 Exposure weighted average PD %	2016 Exposure weighted average LGD[1] %	2016 Average risk weight %	2016 Undrawn commitments (pre CCF)[2] £m	2016 Undrawn commitments (post CCF) £m
UK mainstream	238,980	2.41%	9.83%	9.23%	8,766	8,502
UK buy-to-let	58,108	1.63%	10.78%	13.06%	1,621	1,578
UK self certified	16,390	7.38%	9.36%	14.48%	511	262
Irish mortgages	3,653	9.13%	43.20%	98.18%	–	–
Dutch mortgages	5,847	1.73%	24.40%	23.36%	478	117
Other mortgages	12,532	4.34%	16.03%	23.10%	761	743
Total	335,510	2.62%	10.82%	11.79%	12,137	11,202

1 The 10 per cent LGD floor that applies to residential mortgage exposures is not applied in alignment with the portfolios in the table above, rather at aggregated portfolio levels. This leads to the mainstream and self-certified portfolios having an average LGD lower than 10 per cent.

2 Undrawn commitments predominantly relate to pipeline mortgages, offered but not drawn down by the customer.

Key movements

– Total mortgages exposure reduced by £1.2bn to £334.4bn. The closed UK self certified and Irish portfolios have continued to run-off.

Pillar 1 Capital requirements: Credit risk continued

Table 31: IRB – Credit risk exposures by portfolio and PD range – Qualifying revolving retail exposures (CR6)

PD Scale Qualifying revolving retail exposures	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m	2017 Undrawn commitments (post CCF) £m
0.00 to <0.15	801	14,207	71.05%	10,894	0.09%	7,772,519	67.06%	418	3.84%	7		10,093
0.15 to <0.25	606	6,917	68.54%	5,347	0.20%	3,770,664	70.09%	424	7.92%	8		4,741
0.25 to <0.50	1,647	9,644	63.49%	7,771	0.36%	5,227,102	73.05%	1,036	13.33%	21		6,123
0.50 to <0.75	1,301	3,793	67.38%	3,857	0.62%	2,792,152	76.36%	824	21.37%	18		2,555
0.75 to <2.50	4,133	4,621	81.06%	7,879	1.38%	5,963,333	79.39%	3,190	40.48%	86		3,746
2.50 to <10.00	2,143	1,267	96.89%	3,371	4.52%	1,738,615	80.22%	2,995	88.84%	122		1,228
10.00 to <100.00	613	125	131.30%	797	30.41%	582,427	78.41%	1,704	213.78%	191		164
100.00 (Default)	369	31	0.25%	369	100.00%	724,839	48.31%	550	149.26%	176		–
Sub-total	**11,613**	**40,606**	**70.56%**	**40,285**	**2.34%**	**28,571,651**	**73.07%**	**11,142**	**27.66%**	**628**	**251**	**28,651**

PD Scale Qualifying revolving retail exposures	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m	2016 Undrawn commitments (post CCF) £m
0.00 to <0.15	896	18,975	64.83%	13,198	0.07%	10,510,198	75.23%	446	3.38%	7		12,302
0.15 to <0.25	665	5,701	56.12%	3,864	0.20%	2,674,829	74.77%	328	8.49%	6		3,199
0.25 to <0.50	1,161	5,666	61.92%	4,669	0.36%	4,577,241	77.26%	649	13.89%	13		3,508
0.50 to <0.75	1,049	2,883	64.46%	2,908	0.62%	2,544,591	79.32%	644	22.13%	14		1,858
0.75 to <2.50	3,476	4,630	62.37%	6,364	1.41%	3,859,895	79.61%	2,636	41.42%	72		2,888
2.50 to <10.00	3,148	2,040	73.46%	4,648	5.06%	2,788,757	80.33%	4,733	101.84%	189		1,499
10.00 to <100.00	734	150	124.07%	924	23.17%	617,086	80.98%	1,850	200.15%	173		186
100.00 (Default)	409	45	0.02%	409	100.00%	165,350	37.59%	787	192.13%	166		–
Sub-total	11,538	40,090	63.46%	36,984	2.70%	27,737,947	76.88%	12,073	32.64%	640	241	25,440

Key movements

- EAD post CRM and post CCF increased by £3.3bn to £40.3bn mainly due to model calibrations.
- The implementation of an improved LGD model for Lloyds Bank Credit Cards and Overdrafts rating systems during 2017 has led to a reduction in average LGD. The scope of the new model includes assets in recoveries leading to an increase in In Default obligors at the end of the year.
- The implementation of an improved PD model in 2017 for HBOS and Lloyds Bank Credit Cards and Overdrafts rating systems has resulted in some grade migration, particularly in the lowest risk grades. Refer to Model Performance section on pages 37 to 48 for further details.

Pillar 1 Capital requirements: Credit risk continued

Table 32: IRB – Credit risk exposures by portfolio and PD range – Other SME (CR6)

PD Scale Other SME	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m	2017 Undrawn commitments (post CCF) £m
0.00 to <0.15	–	–	–	–	–	–	–	–	–	–		–
0.15 to <0.25	–	–	–	–	–	–	–	–	–	–		–
0.25 to <0.50	–	–	–	–	–	–	–	–	–	–		–
0.50 to <0.75	251	313	99.99%	563	0.54%	50,000	76.91%	293	51.99%	2		313
0.75 to <2.50	480	363	99.99%	843	1.15%	63,175	76.91%	578	68.55%	7		363
2.50 to <10.00	320	121	99.99%	441	4.53%	33,777	78.51%	427	96.66%	16		121
10.00 to <100.00	112	23	99.99%	135	23.51%	32,278	83.98%	183	135.37%	27		23
100.00 (Default)	213	3	100.00%	217	100.00%	9,960	11.62%	97	44.78%	25		3
Sub-total	**1,377**	**823**	**99.99%**	**2,200**	**12.78%**	**189,190**	**71.24%**	**1,578**	**71.72%**	**78**	**16**	**823**

PD Scale Other SME	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m	2016 Undrawn commitments (post CCF) £m
0.00 to <0.15	–	–	–	–	–	–	–	–	–	–		–
0.15 to <0.25	–	–	–	–	–	–	–	–	–	–		–
0.25 to <0.50	–	–	–	–	–	–	–	–	–	–		–
0.50 to <0.75	303	375	99.99%	678	0.54%	56,640	77.38%	345	50.86%	3		375
0.75 to <2.50	575	332	99.98%	907	1.15%	58,385	75.42%	622	68.60%	8		332
2.50 to <10.00	360	110	99.98%	470	4.52%	33,524	77.10%	451	96.16%	16		110
10.00 to <100.00	127	22	99.98%	148	23.00%	32,132	81.13%	198	133.37%	28		22
100.00 (Default)	238	3	99.86%	242	100.00%	10,207	9.39%	112	46.20%	23		3
Sub-total	1,603	842	99.98%	2,445	12.74%	190,888	70.10%	1,728	70.68%	78	13	842

Pillar 1 Capital requirements: Credit risk continued

Table 33: IRB – Credit risk exposures by portfolio and PD range – Other non-SME (CR6)

PD Scale Other non-SME	2017 Original on-balance sheet gross exposure £m	2017 Off balance sheet exposures pre CCF £m	2017 Average CCF %	2017 EAD post CRM and post CCF £m	2017 Average PD %	2017 Number of Obligors	2017 Average LGD %	2017 RWA £m	2017 RWA density %	2017 EL £m	2017 Value adjustments and Provisions £m	2017 Undrawn commitments (post CCF) £m
0.00 to <0.15	262	–	–	262	0.08%	19,348	34.41%	20	7.81%	–		–
0.15 to <0.25	76	1	30.00%	79	0.21%	16,098	79.39%	28	35.57%	–		–
0.25 to <0.50	4,068	6	30.00%	4,081	0.37%	418,457	39.69%	1,044	25.59%	6		2
0.50 to <0.75	2,595	6	30.00%	2,608	0.70%	265,347	48.98%	1,146	43.94%	9		2
0.75 to <2.50	6,901	23	30.00%	6,954	1.52%	781,574	63.65%	5,440	78.23%	66		7
2.50 to <10.00	2,966	12	30.00%	2,993	4.25%	383,894	69.11%	3,166	105.78%	88		4
10.00 to <100.00	562	3	30.00%	568	33.14%	80,753	58.28%	732	128.80%	115		1
100.00 (Default)	298	–	–	298	100.00%	125,333	49.79%	529	177.71%	116		–
Sub-total	**17,727**	**51**	**30.00%**	**17,843**	**4.22%**	**2,090,804**	**56.18%**	**12,106**	**67.85%**	**400**	**261**	**15**

PD Scale Other non-SME	2016 Original on-balance sheet gross exposure £m	2016 Off balance sheet exposures pre CCF £m	2016 Average CCF %	2016 EAD post CRM and post CCF £m	2016 Average PD %	2016 Number of Obligors	2016 Average LGD %	2016 RWA £m	2016 RWA density %	2016 EL £m	2016 Value adjustments and Provisions £m	2016 Undrawn commitments (post CCF) £m
0.00 to <0.15	314	1	30.00%	315	0.09%	34,244	40.65%	32	10.15%	–		–
0.15 to <0.25	149	2	30.00%	152	0.21%	26,947	83.43%	56	36.79%	–		–
0.25 to <0.50	3,566	6	30.00%	3,580	0.37%	395,742	42.58%	980	27.39%	6		2
0.50 to <0.75	2,206	5	30.00%	2,219	0.71%	239,467	50.28%	1,002	45.14%	8		2
0.75 to <2.50	6,153	19	30.00%	6,199	1.54%	734,596	67.40%	5,169	83.39%	63		6
2.50 to <10.00	2,691	12	30.00%	2,721	4.30%	350,106	74.05%	3,087	113.47%	87		4
10.00 to <100.00	538	4	30.00%	546	28.63%	88,692	66.81%	793	145.41%	103		1
100.00 (Default)	294	–	–	294	100.00%	25,519	33.16%	499	169.46%	117		–
Sub-total	15,911	49	30.00%	16,026	4.32%	1,895,313	59.59%	11,618	72.50%	384	201	15

Key movements

– EAD post CRM and post CCF and risk weighted assets increased by £1.8bn and £0.5bn respectively due to growth in the UK Motor Finance business.

– The impact of growth on risk weighted assets is partially offset by a reduction in average LGD due to a higher proportion of UK Motor Finance assets, where LGDs are materially lower than for loans due to its asset-backed structure, and the implementation of an improved LGD model for the Lloyds Bank Loans rating system. Refer to Model Performance section on pages 37 to 48 for further details.

– The scope of the new LGD model includes assets in recoveries leading to an increase in In Default obligors at the end of the year.

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 four sub-classes of specialised lending recognised by the PRA: i.e. project finance, object finance, commodities finance and income-producing real estate.

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 2017, corporate specialised lending exposures subject to supervisory slotting amounted to £16.1bn (2016: £18.8bn). Risk-weighted assets arising from this amounted to £12.0bn (2016: £13.5bn) as analysed in the table below.

Exposures in the table below are stated on two different bases. On-balance sheet and off-balance sheet amounts represent net carrying values (after taking into account SCRAs) before the application of CRM and CCF. Exposure amount represents EAD post CRM and post CCF.

Table 34A: IRB – Specialised lending (CR10)

		2017					
		Specialised lending					
Regulatory Categories	Remaining maturity	On-balance sheet amount £m	Off-balance sheet amount £m	RW %	Exposure amount £m	RWA £m	Expected losses £m
1) Strong	Less than 2.5 years	2,784	673	50%	3,168	1,587	–
	Equal to or more than 2.5 years	2,999	951	70%	3,446	2,412	14
2) Good	Less than 2.5 years	2,314	449	70%	2,686	1,881	11
	Equal to or more than 2.5 years	4,778	424	90%	5,148	4,629	41
3) Satisfactory	Less than 2.5 years	160	27	115%	182	209	5
	Equal to or more than 2.5 years	791	64	115%	860	982	24
4) Weak	Less than 2.5 years	20	1	250%	21	51	2
	Equal to or more than 2.5 years	84	1	250%	86	214	7
5) Default	Less than 2.5 years	257	25	0%	374	–	187
	Equal to or more than 2.5 years	74	52	0%	146	–	73
Total	Less than 2.5 years	5,534	1,174		6,431	3,728	205
	Equal to or more than 2.5 years	8,727	1,491		9,686	8,237	159

		2016					
		Specialised lending					
Regulatory Categories	Remaining maturity	On-balance sheet amount £m	Off-balance sheet amount £m	RW %	Exposure amount £m	RWA £m	Expected losses £m
1) Strong	Less than 2.5 years	2,356	505	50%	2,772	1,192	–
	Equal to or more than 2.5 years	4,255	1,164	70%	5,090	3,307	19
2) Good	Less than 2.5 years	2,465	644	70%	3,004	2,102	12
	Equal to or more than 2.5 years	4,294	642	90%	4,890	4,312	38
3) Satisfactory	Less than 2.5 years	709	20	115%	736	843	21
	Equal to or more than 2.5 years	1,097	89	115%	1,183	1,349	33
4) Weak	Less than 2.5 years	29	1	250%	30	73	2
	Equal to or more than 2.5 years	116	–	250%	116	289	9
5) Default	Less than 2.5 years	406	37	0%	655	–	328
	Equal to or more than 2.5 years	207	8	0%	338	–	170
Total	Less than 2.5 years	5,965	1,207		7,197	4,210	363
	Equal to or more than 2.5 years	9,969	1,903		11,617	9,257	269

Key movements

- Corporate specialised lending (slotting) exposures and risk-weighted assets reduced by £2.7bn and £1.5bn respectively mainly due to active portfolio management and securitisation activity.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF EQUITY EXPOSURES

EQUITY EXPOSURES SUBJECT TO THE SIMPLE RISK WEIGHT METHOD

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

As at 31 December 2017, total credit risk exposures in respect of equities subject to the Simple Risk Weight Method amounted to £3.4bn (2016: £3.4bn). Risk-weighted assets arising from this amounted to £7.4bn (2016: £7.7bn).

Table 34B: Equity exposures subject to the simple risk weight method (CR10)

2017						
	Equities under the simple risk-weight approach					
Categories	On-balance sheet amount £m	Off-balance sheet amount £m	RW %	Exposure amount £m	RWA £m	Capital requirements £m
Exchange-traded equity exposures	573	–	290%	573	1,662	133
Private equity exposures[1]	2,439	101	190%	2,540	4,827	386
Other equity exposures	241	–	370%	241	893	71
Total	3,254	101		3,355	7,381	591

2016						
	Equities under the simple risk-weight approach					
Categories	On-balance sheet amount £m	Off-balance sheet amount £m	RW %	Exposure amount £m	RWA £m	Capital requirements £m
Exchange-traded equity exposures	461	–	290%	461	1,337	107
Private equity exposures[1]	2,492	91	190%	2,583	4,909	393
Other equity exposures	382	–	370%	382	1,413	113
Total	3,335	91		3,426	7,659	613

1 The Group's private equity investments predominantly consist of venture capital investments. The equity component of which is reflected through both equity exposures (Table 34B) and the analysis of non-trading book exposures in equities (Table 35). Equity exposures in Table 34B also include the investment in debt securities issued by venture capital entities.

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.

The Group's strategic equity investments predominantly arise as a result of management actions undertaken by the Group resulting in equity holdings.

Private equity investments are generally medium term investments, held for gain and include limited partnership stakes and listed and unlisted equity shares. Private equity investments are managed, and evaluated, in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

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

Available-for-sale financial assets, Note 2 (Accounting policies) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Equity investments (including venture capital), Note 48 (Financial instruments) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

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 73.

The balance sheet value of non-trading book exposures in equities, as at 31 December 2017, is presented in the table below. There was no difference between the balance sheet value and the fair value of these exposures.

Table 35: Analysis of non-trading book exposures in equities

Equity grouping	2017 Balance sheet value £m	2016 Balance sheet value £m
Publicly quoted equities	563	469
Privately held equities[1]	1,423	1,571
Total	1,986	2,040

There were £83m (2016: £311m) realised gains recognised in the year to 31 December 2017 in respect of the sale and liquidation of non-trading book exposures in equities.

As at 31 December 2017, net unrealised gains on available-for-sale equity investments amounted to £87m (2016: £245m).

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES SUBJECT TO THE STANDARDISED APPROACH

Standardised exposures in the table below are stated on two different bases (pre-CCF and CRM and post-CCF and CRM). Note, the exposures are also net of SCRAs.

Throughout this section 'RWA density' represents the 'average risk weight'.

As at 31 December 2017, credit risk exposures risk-weighted under the Standardised Approach post-CCF and CRM, amounted to £113.0bn (2016: £109.4bn), generating risk-weighted assets of £25.3bn (2016: £18.7bn).

Table 36: Standardised approach – credit risk exposure and Credit Risk Mitigation (CRM) effects (CR4)

	2017					
	Exposures pre CCF and CRM		Exposures post-CCF and CRM		RWA and RWA density	
	On balance sheet amount £m	Off balance sheet amount £m	On balance sheet amount £m	Off balance sheet amount £m	RWA £m	RWA density[1] %
Central governments or central banks	76,352	327	76,352	349	8	–
Regional governments or local authorities	5	–	5	–	1	20%
Public sector entities	1	40	1	20	21	100%
Multilateral development banks	1,837	–	1,837	–	–	–
International organisations	–	–	–	–	–	–
Institutions	136	247	135	13	32	22%
Corporates	10,036	8,006	9,600	2,671	10,902	89%
Retail	12,619	21,466	12,619	201	9,256	72%
Secured by mortgages on immovable property	5,148	10	5,148	5	1,944	38%
of which: residential property	5,146	10	5,146	5	1,942	38%
of which: commercial property	2	–	2	–	2	100%
Exposures in default	662	39	661	19	765	112%
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investment undertakings	278	–	278	–	56	20%
Equity exposures	–	–	–	–	–	–
Other items	3,114	–	3,114	–	2,273	73%
Total	**110,187**	**30,136**	**109,750**	**3,278**	**25,259**	**22%**

	2016					
	Exposures pre CCF and CRM		Exposures post-CCF and CRM		RWA and RWA density	
	On balance sheet amount £m	Off balance sheet amount £m	On balance sheet amount £m	Off balance sheet amount £m	RWA £m	RWA density[1] %
Central governments or central banks	80,918	239	80,918	382	–	–
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	2	–	2	–	2	100%
Multilateral development banks	1,753	–	1,753	–	–	–
International organisations	–	–	–	–	–	–
Institutions	218	291	218	14	117	50%
Corporates	10,987	5,945	9,782	2,574	10,801	87%
Retail	3,963	837	3,963	151	2,761	67%
Secured by mortgages on immovable property	5,499	10	5,499	5	1,981	36%
of which: residential property	5,496	10	5,496	5	1,978	36%
of which: commercial property	3	–	3	–	3	100%
Exposures in default	781	17	781	8	883	112%
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investment undertakings	224	–	224	–	45	20%
Equity exposures	–	–	–	–	–	–
Other items	3,016	75	3,016	75	2,098	68%
Total	107,361	7,414	106,156	3,209	18,688	17%

1 RWA density is RWA expressed as a percentage of Exposures post-CCF and CRM.

Key movements

– Retail exposures and risk-weighted assets increased mainly due to the acquisition of MBNA, risk-weighted at 75%, increasing the average risk weight. Other exposures in this asset class benefit from the SME scalar.

– Corporate exposures decreased mainly due to continued portfolio management activity offset by an updated approach to charge-back exposure risk.

Pillar 1 Capital requirements: Credit risk continued

Table 37: Standardised approach – exposures by asset class (CR5)

Exposures in the table below are presented on a post CRM and post CCF basis.

The Group makes limited use of ECAIs assessments for its Standardised exposures. 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.

For the below disclosure, exposures are classed as "rated" only where an ECAI rating has been used to derive the risk weight. Where a rating is unavailable, or where the risk weight has been determined by application of specific CRR provisions, exposures have been classed as "unrated". This also applies to central governments or central banks exposures within the UK and EEA that receive a zero per cent risk weight in line with regulatory permission.

	2017																
	Risk Weight																
Exposure Classes	0% £m	2% £m	4% £m	10% £m	20% £m	35% £m	50% £m	70% £m	75% £m	100% £m	150% £m	250% £m	370% £m	1250% £m	Others £m	Total £m	Of which: Unrated £m
Central governments or central banks	76,660	–	–	–	41	–	–	–	–	–	–	–	–	–	–	76,701	76,701
Regional government or local authorities	–	–	–	–	5	–	–	–	–	–	–	–	–	–	–	5	5
Public sector entities	–	–	–	–	–	–	–	–	–	21	–	–	–	–	–	21	21
Multilateral development banks	1,837	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1,837	1,837
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	29	–	–	–	100	–	16	–	–	4	–	–	–	–	–	149	59
Corporates	–	–	–	–	217	–	1,805	–	–	10,248	–	–	–	–	–	12,271	10,187
Retail	–	–	–	–	–	–	–	–	12,819	–	–	–	–	–	–	12,819	12,819
Secured by mortgages on immovable property	–	–	–	–	–	4,695	183	–	260	14	–	–	–	–	–	5,153	5,153
of which: residential property	–	–	–	–	–	4,695	183	–	260	12	–	–	–	–	–	5,151	5,151
of which: commercial property	–	–	–	–	–	–	–	–	–	2	–	–	–	–	–	2	2
Exposures in default	–	–	–	–	–	–	–	–	–	510	170	–	–	–	–	680	680
Items associated with particularly high risk	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investment undertakings	–	–	–	–	278	–	–	–	–	–	–	–	–	–	–	278	–
Equity	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Other items	195	–	–	–	807	–	–	–	–	2,111	–	–	–	–	–	3,114	3,114
Total	**78,721**	**–**	**–**	**–**	**1,448**	**4,695**	**2,005**	**–**	**13,080**	**12,908**	**170**	**–**	**–**	**–**	**–**	**113,028**	**110,576**

	2016																
	Risk Weight																
Exposure Classes	0% £m	2% £m	4% £m	10% £m	20% £m	35% £m	50% £m	70% £m	75% £m	100% £m	150% £m	250% £m	370% £m	1250% £m	Others £m	Total £m	Of which: Unrated £m
Central governments or central banks	81,300	–	–	–	–	–	–	–	–	–	–	–	–	–	–	81,300	81,300
Regional government or local authorities	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Public sector entities	–	–	–	–	–	–	–	–	–	2	–	–	–	–	–	2	2
Multilateral development banks	1,753	–	–	–	–	–	–	–	–	–	–	–	–	–	–	1,753	1,753
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	–	–	–	–	115	–	47	–	–	70	–	–	–	–	–	232	10
Corporates	–	–	–	–	198	–	2,275	–	–	9,882	1	–	–	–	–	12,356	9,767
Retail	–	–	–	–	–	–	–	–	4,110	4	–	–	–	–	–	4,114	4,114
Secured by mortgages on immovable property	–	–	–	–	–	5,229	235	–	27	13	–	–	–	–	–	5,504	5,504
of which: residential property	–	–	–	–	–	5,229	235	–	27	10	–	–	–	–	–	5,501	5,501
of which: commercial property	–	–	–	–	–	–	–	–	–	3	–	–	–	–	–	3	3
Exposures in default	–	–	–	–	–	–	–	–	–	600	189	–	–	–	–	789	789
Items associated with particularly high risk	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investment undertakings	–	–	–	–	224	–	–	–	–	–	–	–	–	–	–	224	–
Equity	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Other items	223	–	–	–	963	–	–	–	–	1,905	–	–	–	–	–	3,091	3,091
Total	83,276	–	–	–	1,500	5,229	2,557	–	4,137	12,476	190	–	–	–	–	109,365	106,330

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES BY GEOGRAPHY

Credit risk exposures as at 31 December 2017, analysed by geographical region, based on country of residence/incorporation of the customers, are provided in the table below. Exposures are presented are on a pre CRM and post CCF basis.

Table 38: Geographical breakdown of exposures (CRB-C)

	2017 United Kingdom £m	2017 Rest of Europe £m	2017 United States of America £m	2017 Asia-Pacific £m	2017 Other £m	2017 Total £m
Central governments or central banks	50	–	17,468	–	204	17,722
Institutions	1,551	893	419	585	724	4,173
Corporates	76,554	12,022	11,366	436	3,329	103,708
of which: Specialised lending	12,974	2,131	420	104	966	16,596
of which: SMEs	11,510	29	–	–	123	11,662
Retail	384,607	10,074	–	1	4	394,687
Secured by real estate property	324,338	10,016	–	1	4	334,359
SMEs	9,760	4	–	1	4	9,769
Non-SMEs	314,578	10,013	–	–	–	324,590
Qualifying revolving	40,285	–	–	–	–	40,285
Other retail	19,984	58	–	–	–	20,043
SMEs	2,199	–	–	–	–	2,200
Non-SMEs	17,785	58	–	–	–	17,843
Equity	3,151	184	13	6	–	3,355
Non-credit obligation assets	10,181	27	–	–	–	10,208
Total IRB approach	476,094	23,201	29,267	1,028	4,261	533,852
Central governments or central banks	61,815	14,582	–	–	41	76,438
Regional governments or local authorities	5	–	–	–	–	5
Public sector entities	21	–	–	–	–	21
Multilateral development banks	37	376	1,264	160	–	1,837
International organisations	–	–	–	–	–	–
Institutions	85	50	49	–	4	189
Corporates	7,427	1,527	2,225	381	1,165	12,724
Retail	11,342	1,463	2	7	6	12,819
Secured by mortgages on immovable property	4,296	241	84	408	124	5,153
Exposures in default	571	85	5	9	11	681
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investments undertakings	278	–	–	–	–	278
Equity exposures	–	–	–	–	–	–
Other exposures	2,957	64	15	5	73	3,114
Total standardised approach	88,834	18,388	3,643	970	1,424	113,259
Total	564,928	41,589	32,911	1,999	5,685	647,111

Pillar 1 Capital requirements: Credit risk continued

	2016 United Kingdom £m	2016 Rest of Europe £m	2016 United States of America £m	2016 Asia-Pacific £m	2016 Other £m	2016 Total £m
Central governments or central banks	–	156	14,779	–	218	15,153
Institutions	1,793	2,039	1,252	424	503	6,011
Corporates	81,131	11,671	12,210	741	3,571	109,324
of which: Specialised lending	14,391	2,818	569	114	924	18,816
of which: SMEs	11,887	33	–	–	61	11,981
Retail	381,402	9,556	–	1	6	390,965
Secured by real estate property	326,000	9,504	–	1	5	335,510
SMEs	10,201	4	–	1	5	10,211
Non-SMEs	315,799	9,500	–	–	–	325,299
Qualifying revolving	36,984	–	–	–	–	36,984
Other retail	18,418	52	–	–	1	18,471
SMEs	2,444	–	–	–	1	2,445
Non-SMEs	15,974	52	–	–	–	16,026
Equity	3,208	156	60	2	–	3,426
Non-credit obligation assets	10,856	34	–	–	–	10,890
Total IRB approach	478,389	23,613	28,301	1,168	4,298	535,769
Central governments or central banks	69,957	11,064	–	–	–	81,021
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	2	–	–	–	–	2
Multilateral development banks	41	397	1,283	32	–	1,753
International organisations	–	–	–	–	–	–
Institutions	90	101	87	1	–	279
Corporates	8,057	1,940	2,193	284	1,037	13,511
Retail	2,755	1,339	2	9	9	4,114
Secured by mortgages on immovable property	4,479	276	100	501	148	5,504
Exposures in default	707	48	6	10	18	789
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investments undertakings	224	–	–	–	–	224
Equity exposures	–	–	–	–	–	–
Other exposures	2,923	62	–	5	101	3,091
Total standardised approach	89,235	15,227	3,671	842	1,313	110,288
Total	567,624	38,840	31,972	2,010	5,611	646,057

Pillar 1 Capital requirements: Credit risk continued

Exposures in the table below are presented are on a pre CRM and post CCF basis.

Table 39: Exposures subject to the IRB approach analysed by geographical region

	2017 United Kingdom			2017 Rest of Europe			2017 United States of America			2017 Asia-Pacific			2017 Other			2017 Total		
	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %
Exposures subject to the IRB approach																		
Foundation IRB approach																		
Central governments or central banks	50		0.01%	–		–	17,468		0.01%	–		–	204		0.01%	17,722		0.01%
Institutions	1,551		0.14%	893		0.13%	419		0.06%	585		4.89%	724		0.22%	4,173		0.68%
Corporate – main	52,070		2.52%	9,862		0.53%	10,946		0.34%	332		0.28%	2,240		0.24%	75,450		1.86%
Corporate – SME	11,510		5.64%	29		1.16%	–		–	–		–	123		0.29%	11,662		5.57%
Corporate – specialised lending[1]	1		45.24%	–		–	–		–	–		–	–		–	1		45.24%
Total – Foundation IRB approach	65,182		3.02%	10,784		0.50%	28,834		0.13%	917		3.22%	3,291		0.22%	109,008		1.90%
Retail IRB approach																		
Retail mortgages	324,338	10.41%	2.40%	10,016	29.86%	4.28%	–	–	–	1	10.82%	1.01%	4	12.59%	1.36%	334,359	10.99%	2.46%
of which: residential mortgages (SME)	9,760	16.69%	4.17%	4	11.71%	1.33%	–	–	–	1	10.82%	1.01%	4	12.59%	1.36%	9,769	16.69%	4.17%
of which: residential mortgages (non-SME)	314,578	10.21%	2.34%	10,013	29.86%	4.28%	–	–	–	–	–	–	–	–	–	324,590	10.82%	2.40%
Qualifying revolving retail exposures	40,285	73.07%	2.34%	–	–	–	–	–	–	–	–	–	–	–	–	40,285	73.07%	2.34%
Other SME	2,200	71.24%	12.78%	–	–	–	–	–	–	–	–	–	–	–	–	2,200	71.24%	12.78%
Other non-SME	17,785	56.23%	4.23%	58	40.25%	1.09%	–	–	–	–	–	–	–	–	–	17,843	56.18%	4.22%
Total – Retail IRB approach	384,607	19.44%	2.54%	10,074	29.92%	4.26%	–	–	–	1	10.82%	1.01%	4	12.59%	1.36%	394,687	19.71%	2.58%

	2016 United Kingdom			2016 Rest of Europe			2016 United States of America			2016 Asia-Pacific			2016 Other			2016 Total		
	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %	Credit risk exposure £m	LGD %	PD %
Exposures subject to the IRB approach																		
Foundation IRB approach																		
Central governments or central banks	–		–	156		0.01%	14,779		0.01%	–		–	218		0.01%	15,153		0.01%
Institutions	1,793		0.83%	2,039		0.07%	1,252		0.07%	424		6.94%	503		0.18%	6,011		0.78%
Corporate – main	54,852		2.23%	8,821		0.68%	11,641		0.21%	627		0.21%	2,586		0.20%	78,527		1.67%
Corporate – SME	11,887		6.82%	33		8.26%	–		–	–		–	61		0.67%	11,981		6.79%
Corporate – specialised lending[1]	2		4.78%	–		–	–		–	–		–	–		–	2		4.78%
Total – Foundation IRB approach	68,534		2.99%	11,049		0.55%	27,672		0.10%	1,051		2.93%	3,368		0.20%	111,674		1.95%
Retail IRB approach																		
Retail mortgages	326,000	10.22%	2.56%	9,504	31.62%	4.57%	–	–	–	1	10.82%	0.63%	5	16.59%	2.48%	335,510	10.82%	2.62%
of which: residential mortgages (SME)	10,201	16.97%	4.69%	4	11.84%	2.03%	–	–	–	1	10.82%	0.63%	5	16.59%	2.48%	10,211	16.97%	4.68%
of which: residential mortgages (non-SME)	315,799	10.00%	2.50%	9,500	31.63%	4.58%	–	–	–	–	–	–	–	–	–	325,299	10.63%	2.56%
Qualifying revolving retail exposures	36,984	76.88%	2.70%	–	–	–	–	–	–	–	–	–	–	–	–	36,984	76.88%	2.70%
Other SME	2,444	70.10%	12.74%	–	–	–	–	–	–	–	–	–	1	62.78%	2.61%	2,445	70.10%	12.74%
Other non-SME	15,974	59.65%	4.33%	52	40.91%	1.17%	–	–	–	–	–	–	–	–	–	16,026	59.59%	4.32%
Total – Retail IRB approach	381,402	19.14%	2.72%	9,556	31.67%	4.56%	–	–	–	1	10.82%	0.63%	6	24.86%	2.50%	390,965	19.44%	2.76%

1 Corporate-specialised lending includes those exposures subject to the Foundation IRB approach only and does not include exposures subject to supervisory slotting (refer to Table 34A on page 62).

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES BY INDUSTRY

Credit risk exposures as at 31 December 2017, analysed by major industrial sector, are provided in the table below. Exposures are presented are on a pre CRM and post CCF basis.

Table 40: Concentration of exposures by industry (CRB-D)

	2017 Agriculture, forestry and fishing £m	2017 Energy and water supply £m	2017 Manufacturing £m	2017 Construction £m	2017 Transport, distribution and hotels £m	2017 Postal and comms £m	2017 Property companies £m	2017 Financial, business and other services £m	2017 Personal: mortgages £m	2017 Personal: other £m	2017 Lease financing £m	2017 Hire purchase £m	2017 Total £m
Central governments or central banks	–	–	–	–	–	–	–	17,722	–	–	–	–	17,722
Institutions	–	–	–	–	–	–	–	4,064	–	–	60	49	4,173
Corporates	1,433	3,777	12,396	4,489	16,187	1,570	24,372	34,038	–	–	2,584	2,862	103,708
of which: Specialised lending	10	1,092	234	160	982	121	13,296	308	–	–	392	–	16,596
of which: SMEs	1,203	39	1,420	538	2,524	71	1,888	3,591	–	–	37	352	11,662
Retail	1,672	10	514	614	2,127	41	4,358	2,629	324,590	48,396	–	9,736	394,687
Secured by real estate property	1,475	8	344	312	1,619	27	4,108	1,875	324,590	1	–	–	334,359
SMEs	1,475	8	344	312	1,619	27	4,108	1,875	–	1	–	–	9,769
Non-SMEs	–	–	–	–	–	–	–	–	324,590	–	–	–	324,590
Qualifying revolving	–	–	–	–	–	–	–	–	–	40,285	–	–	40,285
Other retail	197	1	171	301	509	14	250	754	–	8,110	–	9,736	20,043
SMEs	197	1	171	301	509	14	250	754	–	3	–	–	2,200
Non-SMEs	–	–	–	–	–	–	–	–	–	8,107	–	9,736	17,843
Equity	–	33	315	93	253	321	91	2,249	–	–	–	–	3,355
Non-credit obligation assets													10,208
Total IRB approach	3,105	3,819	13,226	5,195	18,567	1,932	28,820	60,702	324,590	48,397	2,644	12,648	533,852
Central governments or central banks	–	–	–	–	–	–	–	76,412	–	–	26	–	76,438
Regional governments or local authorities	–	–	–	–	–	–	–	5	–	–	–	–	5
Public sector entities	–	–	–	–	–	–	–	21	–	–	–	–	21
Multilateral development banks	–	–	–	–	–	–	–	1,837	–	–	–	–	1,837
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	–	–	–	–	1	–	–	184	–	–	4	–	189
Corporates	1,837	305	1,472	105	3,391	141	1,033	3,632	60	412	282	55	12,724
Retail	1,158	4	21	22	154	1	224	207	1,038	9,144	264	583	12,819
Secured by mortgages on immovable property	–	–	–	–	–	–	4	276	4,872	–	–	–	5,153
Exposures in default	38	–	5	1	8	–	65	22	447	92	1	2	681
Items associated with particularly high risk	–	–	–	–	–	–	–	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investments undertakings	–	–	–	–	–	–	–	278	–	–	–	–	278
Equity exposures	–	–	–	–	–	–	–	–	–	–	–	–	–
Other exposures													3,114
Total standardised approach	3,033	309	1,498	128	3,553	142	1,326	82,874	6,416	9,649	578	639	113,259
Total	6,138	4,128	14,724	5,323	22,120	2,074	30,146	143,576	331,006	58,045	3,222	13,287	647,111

Pillar 1 Capital requirements: Credit risk continued

	2016 Agriculture, forestry and fishing £m	2016 Energy and water supply £m	2016 Manufacturing £m	2016 Construction £m	2016 Transport, distribution and hotels £m	2016 Postal and comms £m	2016 Property companies £m	2016 Financial, business and other services £m	2016 Personal: mortgages £m	2016 Personal: other £m	2016 Lease financing £m	2016 Hire purchase £m	2016 Total £m
Central governments or central banks	–	–	–	–	–	–	–	15,153	–	–	–	–	15,153
Institutions	–	3	–	10	–	–	–	5,901	–	–	55	42	6,011
Corporates	1,478	4,498	13,883	3,945	16,306	2,141	26,709	34,660	–	–	2,978	2,726	109,324
of which: Specialised lending	–	1,067	325	254	995	32	14,855	570	–	–	718	–	18,816
of which: SMEs	1,265	44	1,371	462	2,706	43	2,110	3,613	–	–	39	328	11,981
Retail	1,729	10	526	635	2,269	47	4,656	2,779	325,299	44,805	–	8,210	390,965
Secured by real estate property	1,512	7	346	321	1,707	32	4,324	1,960	325,299	2	–	–	335,510
SMEs	1,512	7	346	321	1,707	32	4,324	1,960	–	2	–	–	10,211
Non-SMEs	–	–	–	–	–	–	–	–	325,299	–	–	–	325,299
Qualifying revolving	–	–	–	–	–	–	–	–	–	36,984	–	–	36,984
Other retail	217	3	180	314	562	15	333	818	–	7,819	–	8,210	18,471
SMEs	217	3	180	314	562	15	333	818	–	3	–	–	2,445
Non-SMEs	–	–	–	–	–	–	–	–	–	7,816	–	8,210	16,026
Equity	–	84	223	145	320	474	43	2,137	–	–	–	–	3,426
Non-credit obligation assets													10,890
Total IRB approach	3,207	4,595	14,632	4,735	18,895	2,662	31,409	60,629	325,299	44,805	3,033	10,978	535,769
Central governments or central banks	–	–	–	–	–	–	–	81,021	–	–	–	–	81,021
Regional governments or local authorities	–	–	–	–	–	–	–	–	–	–	–	–	–
Public sector entities	–	–	–	–	–	–	–	2	–	–	–	–	2
Multilateral development banks	–	–	–	–	–	–	–	1,753	–	–	–	–	1,753
International organisations	–	–	–	–	–	–	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	–	–	271	–	–	8	–	279
Corporates	1,565	322	1,791	103	2,862	103	1,022	4,177	96	948	475	47	13,511
Retail	1,060	3	23	20	148	1	225	176	977	1,040	–	441	4,114
Secured by mortgages on immovable property	–	–	1	–	–	–	1	253	5,249	1	–	–	5,504
Exposures in default	13	–	6	15	25	–	136	33	476	82	1	2	789
Items associated with particularly high risk	–	–	–	–	–	–	–	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–	–	–	–	–	–	–
Collective investments undertakings	–	–	–	–	–	–	–	224	–	–	–	–	224
Equity exposures	–	–	–	–	–	–	–	–	–	–	–	–	–
Other exposures													3,091
Total standardised approach	2,638	325	1,821	138	3,035	104	1,383	87,910	6,798	2,071	484	490	110,288
Total	5,845	4,920	16,453	4,873	21,930	2,766	32,792	148,539	332,097	46,876	3,517	11,468	646,057

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT RISK EXPOSURES BY RESIDUAL MATURITY

Credit risk exposures at 31 December 2017, analysed by residual maturity, are provided in the table below. Exposures are presented are on a pre CRM and post CCF basis.

Table 41: Maturity of exposures (CRB-E)

	2017					
	Net exposure value					
	On demand £m	<= 1 year £m	> 1 year <= 5 years £m	> 5 years £m	No stated maturity £m	Total £m
Central governments or central banks	–	8,493	4,625	4,604	–	17,722
Institutions	628	2,463	1,057	25	–	4,173
Corporates	7,506	25,727	51,337	19,138	–	103,708
of which: Specialised lending	208	2,661	8,615	5,112	–	16,596
of which: SMEs	976	3,801	2,681	4,204	–	11,662
Retail	41,865	18,663	34,418	299,742	–	394,687
Secured by real estate property	1,469	15,615	19,549	297,726	–	334,359
SMEs	223	1,544	1,105	6,897	–	9,769
Non-SMEs	1,246	14,071	18,445	290,828	–	324,590
Qualifying revolving	40,285	–	–	–	–	40,285
Other retail	111	3,047	14,869	2,016	–	20,043
SMEs	94	1,084	283	739	–	2,200
Non-SMEs	17	1,963	14,586	1,277	–	17,843
Equity	–	–	–	–	3,355	3,355
Non-credit obligation assets	1,646	872	2,192	132	5,367	10,208
Total IRB approach	51,644	56,217	93,629	323,640	8,722	533,852
Central governments or central banks	34,509	13,595	11,772	16,562	–	76,438
Regional governments or local authorities	–	–	–	5	–	5
Public sector entities	–	–	20	1	–	21
Multilateral development banks	–	200	1,388	249	–	1,837
International organisations	–	–	–	–	–	–
Institutions	23	65	95	6	–	189
Corporates	1,326	3,156	3,121	5,123	–	12,724
Retail	8,327	157	1,795	2,541	–	12,819
Secured by mortgages on immovable property	665	154	547	3,787	–	5,153
Exposures in default	76	71	110	424	–	681
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investments undertakings	–	–	–	–	278	278
Equity exposures	–	–	–	–	–	–
Other exposures	215	261	506	455	1,677	3,114
Total standardised approach	45,142	17,657	19,353	29,152	1,955	113,259
Total	96,786	73,875	112,982	352,792	10,677	647,111

Pillar 1 Capital requirements: Credit risk continued

	2016					
	Net exposure value					
	On demand £m	<= 1 year £m	> 1 year <= 5 years £m	> 5 years £m	No stated maturity £m	Total £m
Central governments or central banks	–	6,017	5,025	4,111	–	15,153
Institutions	245	2,988	2,382	396	–	6,011
Corporates	8,301	26,655	52,676	21,692	–	109,324
of which: Specialised lending	297	3,160	8,713	6,646	–	18,816
of which: SMEs	930	3,925	2,629	4,497	–	11,981
Retail	38,534	17,452	32,797	302,182	–	390,965
Secured by real estate property	1,427	14,699	19,063	300,321	–	335,510
SMEs	217	1,539	1,211	7,244	–	10,211
Non-SMEs	1,210	13,160	17,852	293,077	–	325,299
Qualifying revolving	36,984	–	–	–	–	36,984
Other retail	123	2,753	13,734	1,861	–	18,471
SMEs	105	1,114	338	888	–	2,445
Non-SMEs	18	1,639	13,396	973	–	16,026
Equity	–	–	–	–	3,426	3,426
Non-credit obligation assets	4,015	1	177	3,343	3,354	10,890
Total IRB approach	51,095	53,113	93,057	331,724	6,780	535,769
Central governments or central banks	29,220	9,544	10,251	32,006	–	81,021
Regional governments or local authorities	–	–	–	–	–	–
Public sector entities	–	–	–	2	–	2
Multilateral development banks	–	86	1,265	403	–	1,753
International organisations	–	–	–	–	–	–
Institutions	11	159	2	107	–	279
Corporates	807	2,806	3,954	5,944	–	13,511
Retail	198	160	1,312	2,444	–	4,114
Secured by mortgages on immovable property	666	157	496	4,185	–	5,504
Exposures in default	55	54	177	503	–	789
Items associated with particularly high risk	–	–	–	–	–	–
Covered bonds	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Collective investments undertakings	–	–	–	–	224	224
Equity exposures	–	–	–	–	–	–
Other exposures	296	261	130	1,437	968	3,091
Total standardised approach	31,253	13,226	17,587	47,031	1,192	110,288
Total	82,348	66,338	110,644	378,755	7,972	646,057

Pillar 1 Capital requirements: Credit risk continued

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.

For certain retail products, criteria required for the recognition of impairment status may differ from the criteria required for the recognition of regulatory default. This is mainly driven by the different number of days past due, where for standardised portfolios 90 days past due would trigger default status, however, impairment will only be recognised when the assets are 180 days past due.

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(H) (Accounting policies) of the 2017 Lloyds Banking Group plc Annual Report and Accounts:

– (1) Assets accounted for at amortised cost, page 176.
– (2) Available-for-sale financial assets, pages 176 and 177.

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 Group Credit Policies and are maintained by the Risk Division, and Group's Accounting Policies which are maintained by the Finance Division, all of which are renewed and approved on an annual basis.

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 Group'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 Business and Risk Division monitor impairment provisions on a continuous basis throughout the year.

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.

Additionally, on a regular basis, an analysis of impaired exposure and impairment allowances (including potential risks not identified within models for collective provisioning) are provided to Board and Audit Committee.

MANAGEMENT OF CUSTOMERS EXPERIENCING FINANCIAL DISTRESS

Information and analysis on the measures adopted by the Group to support retail and commercial customers experiencing financial difficulty is provided in the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts on pages 118 to 120.

Pillar 1 Capital requirements: Credit risk continued

ANALYSIS OF CREDIT QUALITY OF EXPOSURES

Tables below present analysis of credit risk exposures and credit risk adjustments (including charges in the period) analysed by regulatory exposure class, industry types and geography. Gross carrying value comprises both on and off-balance sheet exposures. Net values represent gross carrying values less specific credit risk adjustments.

The analysis of impairment charge in the period in respect of loans and advances to customers has been presented prior to the application of fair value adjustments which were £85m in 2017 (2016: £65m). The impairment charge increased to £782m in 2017 (2016: £657m), reflecting expected lower provision releases and write-backs and the acquisition of MBNA.

Table 42: Credit quality of exposures by exposure class and instrument (CR1-A)

	2017					
	Gross carrying values of					
	Defaulted exposures £m	Non-defaulted exposures £m	Specific credit risk adjustment £m	General credit risk adjustment[1] £m	Credit risk adjustment charges in the period £m	Net values £m
Central governments or central banks	–	17,722	–	–	–	17,722
Institutions	28	4,759	–	–	–	4,787
Corporates	1,993	117,752	847	–	92	118,898
of which: Specialised lending	524	16,569	166	–	(25)	16,927
of which: SMEs	428	11,981	115	–	(12)	12,294
Retail	4,995	387,600	2,093	–	563	390,502
Secured by real estate property	4,081	316,317	1,565	–	(22)	318,834
SMEs	180	9,606	25	–	7	9,761
Non-SMEs	3,901	306,711	1,540	–	(30)	309,072
Qualifying revolving	400	51,819	251	–	359	51,968
Other retail	514	19,463	277	–	226	19,700
SMEs	217	1,983	16	–	15	2,184
Non-SMEs	298	17,480	261	–	211	17,516
Equity	–	3,355	–	–	–	3,355
Non-credit obligation assets	–	10,231	–	–	–	10,231
Total IRB approach	**7,017**	**541,418**	**2,940**	**–**	**655**	**545,494**
Central governments or central banks		76,679	–	–	–	76,679
Regional governments or local authorities		5	–	–	–	5
Public sector entities		41	–	–	–	41
Multilateral development banks		1,837	–	–	–	1,837
International organisations		–	–	–	–	–
Institutions		383	–	–	–	383
Corporates		18,074	32	–	7	18,042
of which: SMEs		3,492	4	–	–	3,488
Retail		34,159	74	–	57	34,085
of which: SMEs		2,303	3	–	–	2,300
Secured by mortgages on immovable property		5,181	23	–	3	5,158
of which: SMEs		8	–	–	–	8
Exposures in default[2]	1,031	–	330	–	60	701
Items associated with particularly high risk		–	–	–	–	–
Covered bonds		–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment		–	–	–	–	–
Collective investments undertakings		278	–	–	–	278
Equity exposures		–	–	–	–	–
Other exposures		3,114	–	–	–	3,114
Total standardised approach	**1,031**	**139,751**	**459**	**–**	**127**	**140,323**
Total	**8,048**	**681,169**	**3,400**	**–**	**782**	**685,817**
of which: Loans	7,649	426,513	3,225	–	782	430,937
of which: Debt securities	40	3,459	–	–	–	3,499
of which: Off-balance-sheet exposures	359	135,492	175	–	–	135,677

1 The Group does not recognise any general credit risk adjustments (GCRAs) as defined by the EBA.

2 The breakdown of "exposures in default" by the exposure class that corresponds to the exposure before default, comprises Corporate £319m and Retail £712m.

Pillar 1 Capital requirements: Credit risk continued

Table 43: Credit quality of exposures by industry types (CR1-B)

	2017					
	Gross carrying values of					
	Defaulted exposures £m	Non-defaulted exposures £m	Specific credit risk adjustment £m	General credit risk adjustment[1] £m	Credit risk adjustment charges in the period £m	Net values £m
Agriculture, forestry and fishing	143	6,302	18	–	2	6,426
Energy and water supply	1	5,078	5	–	–	5,073
Manufacturing	284	17,980	111	–	5	18,153
Construction	551	5,808	251	–	85	6,108
Transport, distribution and hotels	280	26,322	102	–	(19)	26,500
Postal and communications	4	2,404	3	–	1	2,405
Property companies	995	30,686	343	–	(7)	31,338
Financial, business and other services	433	160,966	204	–	42	161,196
Personal: mortgages	4,471	313,103	1,678	–	(34)	315,896
Personal: other	765	91,897	513	–	596	92,149
Lease financing	8	6,867	2	–	–	6,873
Hire purchase	114	13,756	171	–	111	13,699
Total	8,048	681,169	3,400	–	782	685,817

1 The Group does not recognise any GCRAs as defined by the EBA.

Table 44: Credit quality of exposures by geography (CR1-C)

	2017					
	Gross carrying values of					
	Defaulted exposures £m	Non-defaulted exposures £m	Specific credit risk adjustment £m	General credit risk adjustment[1] £m	Credit risk adjustment charges in the period £m	Net values £m
United Kingdom	7,354	590,813	3,097	–	802	595,071
Rest of Europe	541	44,204	227	–	(19)	44,519
United States of America	78	35,861	51	–	(2)	35,888
Asia-Pacific	39	2,079	4	–	(2)	2,115
Other	36	8,211	21	–	3	8,225
Total	8,048	681,169	3,400	–	782	685,817

1 The Group does not recognise any GCRAs as defined by the EBA.

ANALYSIS OF PAST DUE, NON-PERFORMING AND FORBORNE EXPOSURES

Past due but not impaired loans and advances predominantly represent exposures that are past due 90 days or less. Generally, exposures are considered 'impaired' when they reach a pre-defined level of delinquency, 180 or more days past due for UK mortgages and 60 or more days past due for retail unsecured exposures, or certain cases where the customer is bankrupt. Loans where the Group provides arrangements that forgive a portion of interest or principal are also deemed to be impaired and loans that are originated to refinance currently impaired assets are also defined as impaired. For further details refer to Note 20 on page 195 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

The table below presents past due but not impaired loans and advances analysed by major industrial sector.

Table 45: Past due but not impaired loans and advances analysed by major industrial sector

	Past due but not impaired 2017 £m	Past due but not impaired 2016 £m
Agriculture, forestry and fishing	107	78
Energy and water supply	2	1
Manufacturing	18	17
Construction	18	22
Transport, distribution and hotels	62	93
Postal and communications	2	3
Property companies	60	81
Financial, business and other services	164	92
Personal: mortgages	5,934	7,340
Personal: other	348	201
Lease financing	5	–
Hire purchase	135	103
Total	6,855	8,031

At 31 December 2017 the majority of past due exposures originated from the United Kingdom. Past due exposures originating from the Rest of Europe and United States of America amounted to £281m (2016: £389m) and £nil (2016: £1m) respectively.

Pillar 1 Capital requirements: Credit risk continued

The exposures included in the tables that follow have been prepared in accordance with FINREP regulations and as such the loans and debt securities include balances subject to the credit risk, counterparty credit risk and the securitisation framework. The loans are inclusive of cash and balances held with central banks.

Table 46: Ageing of performing and non-performing exposures[1] (CR1-D hybrid)

	2017						
	Gross carrying values						
	Performing			Non-performing			
	Not past due or Past due <= 30 days £m	Past due > 30 days <= 60 days £m	Past due > 60 days <= 90 days £m	Unlikely to pay that are not past-due or past-due <= 90 days £m	Past due > 90 days <= 180 days £m	Past due > 180 days <= 1 year £m	Past due > 1 year £m
Loans	**511,444**	**1,399**	**686**	**6,102**	**2,158**	**1,800**	**2,832**
Debt securities	**4,172**	**–**	**–**	**–**	**–**	**–**	**40**
Total exposures	**515,616**	**1,399**	**686**	**6,102**	**2,158**	**1,800**	**2,872**

1 Ageing analysis of on-balance-sheet past due exposures regardless of their impairment status.

Table 47: Non-performing and forborne exposures[1] (CR1-E)

	2017												
	Gross carrying amount of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
				of which non-performing				on performing exposures		on non-performing exposures			
	£m	of which performing but past due >30 days and <=90 days £m	of which performing forborne £m	£m	of which: defaulted £m	of which: impaired £m	of which: forborne £m	£m	of which: forborne £m	£m	of which: forborne £m	on non-performing exposures £m	of which: forborne exposures £m
Debt securities	**4,212**	**–**	**–**	**40**	**40**	**40**	**40**	**–**	**–**	**(26)**	**(26)**	**–**	**–**
Loans and advances	**526,421**	**2,086**	**3,395**	**12,891**	**7,994**	**7,790**	**8,467**	**(485)**	**(259)**	**(1,716)**	**(1,279)**	**9,028**	**8,482**
Off balance sheet exposures	**132,759**	**–**	**139**	**360**	**260**	**–**	**264**	**–**	**–**	**–**	**–**	**–**	**–**

1 Forborne exposures included in the table above differ from the forborne loans and advances disclosed within the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts (ARA) (pages 127-130), as they are subject to the FINREP regulations (Annex V) where i) probation periods are typically either two years for performing forborne exposures or three years for non-performing exposures compared to predominantly six months for the forborne balances disclosed in the Annual Report and Accounts; ii) assets in recoveries are considered; iii) Past Term Interest Only Mortgages are classified as forborne; iv) undrawn exposure associated with forborne accounts are included.

COMPARISON OF EXPECTED LOSSES TO SPECIFIC CREDIT RISK ADJUSTMENTS

The table on page 77 provides a comparison of regulatory ELs 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 treatment of regulatory ELs is covered on page 14.

In comparing regulatory ELs 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 ELs 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 EL calculations are predicated on loss estimates over a 12 month time horizon 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 EL calculations forecast potential losses arising from all accounts including those that currently exhibit no indication of impairment;
- Regulatory ELs 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 EL calculations anticipate additional drawings made by customers who are yet to default (EAD estimate). Accounting impairment losses reflect drawn balances and conditions at the balance sheet date; and
- Regulatory ELs generated under the Foundation IRB Approach make use of LGD parameters and CCF (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.

In addition, regulatory ELs in relation to credit portfolios that have rolled out onto IRB models during the year will not be reflected in the ELs 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 ELs to the accounting allowance for impairment losses, consideration of the above should be taken into account.

Where EL exceeds SCRAs linked to the underlying credit risk exposures the resultant excess expected loss (EEL) is deducted from capital resources. Where SCRAs exceed ELs, a 'surplus provision' may be recognised in T2 capital subject to certain restrictions.

Pillar 1 Capital requirements: Credit risk continued

Table 48: Regulatory expected losses and specific credit risk adjustments

	2017 Regulatory expected losses £m	2017 Specific credit risk adjustments £m	2017 Excess expected losses £m	2016 Regulatory expected losses £m	2016 Specific credit risk adjustments £m	2016 Excess expected losses £m	2015 Regulatory expected losses £m	2015 Specific credit risk adjustments £m	2015 Excess expected losses £m
CREDIT RISK									
Foundation IRB approach									
Central governments or central banks	**1**	**–**	**1**	1	–	1	1	–	1
Institutions	**15**	**–**	**15**	21	13	8	12	17	(5)
Corporates	**861**	**682**	**179**	884	632	252	1,103	1,060	43
Retail IRB approach									
Residential mortgages	**954**	**1,474**	**(520)**	880	1,543	(663)	1,094	1,465	(371)
QRRE	**628**	**251**	**378**	640	241	399	611	244	367
Other SME	**78**	**16**	**62**	78	13	65	77	14	63
Other non-SME	**400**	**261**	**139**	384	201	183	332	180	152
Other IRB approaches									
Corporate – specialised lending	**364**	**166**	**198**	632	381	251	941	654	287
Equities	**31**	**–**	**31**	34	–	34	41	–	41
Counterparty credit risk	**53**	**–**	**53**	64	–	64	80	–	80
	3,384	**2,849**	**535**	3,618	3,024	594	4,292	3,634	658
Fair value adjustments[1]		**91**			177			276	
Total prior to additional adjustments	**3,384**	**2,940**	**444**	3,618	3,201	417	4,292	3,910	382
Other adjustments[2]			**53**			185			(112)
Total excess expected losses			**498**			602			270
Reconciliation of SCRAs to statutory consolidated balance sheet allowance for impairment losses on loans and receivables									
Total SCRAs applied against expected losses			**2,940**			3,201			3,910
SCRAs (excluding fair value adjustments) applied to Standardised Approach and other exposures[3]			**405**			406			359
Additional fair value and other adjustments			**(1,118)**			(1,119)			(1,139)
Total per statutory consolidated balance sheet			**2,227**			2,488			3,130

1 The calculation of EEL amounts, where regulatory ELs are netted against SCRAs on IRB portfolios, is subject to the application of acquisition related fair value adjustments.
2 Other adjustments include SCRAs in excess of EL on defaulted exposures which, under CRD IV, may not be offset against non-defaulted EEL, 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 121 and 242, respectively, of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk continued

Key movements (2017)

Retail IRB Residential Mortgages

– The expected loss increase is driven by PRA approved model changes offset by favourable House Price Index (HPI). The group continues to maintain a prudent provisioning policy and this has resulted in SCRAs exceeding regulatory ELs.

Other Retail IRB

– In line with the requirements of the CRR, Retail IRB LGD models are based on "downturn" conditions, resulting in regulatory ELs being in excess of PiT SCRAs. Growth in the UK Motor Finance business and PRA approved model changes, partially offset by continued improvements in credit quality, have driven an increase in regulatory ELs for these portfolios. Other non-SME SCRAs have increased due to portfolio growth and increased provisions for residual value risks reflecting a more conservative outlook on used car prices.

Specialised Lending

– The expected loss reduction of £0.3bn to £0.4bn and the SCRA reduction of £0.2bn to £0.2bn are primarily driven by active portfolio management.

Other adjustments

– Other adjustments have decreased by £0.1bn due to lower surplus SCRA of defaulted exposures and an updated assessment of prudent valuation adjustment.

Key movements (2016)

FIRB Corporates

– The expected loss reduction of £0.2bn to £0.9bn and the SCRA reduction of £0.4bn to £0.6bn are primarily driven by asset reductions and active portfolio management including the disposal of more highly provided defaulted exposures.

Retail IRB Residential Mortgages

– The expected loss reduction of £0.2bn to £0.9bn is driven by PRA approved model changes, favourable HPI and improvements in credit quality. The Group continues to maintain a prudent provisioning policy over its Residential Mortgage portfolio and this has resulted in SCRAs exceeding regulatory ELs despite the majority of ELs being calculated using TTC PD model.

Other Retail IRB (QRRE, Other SME and Other non-SME)

– The Group's Other Retail IRB portfolios are based on model methodologies where the impact of model conservatism results in regulatory ELs being in excess of SCRAs. PRA approved model changes, partially offset by continued improvements in credit quality and a favourable credit environment in 2016 have driven an increase in regulatory ELs for these portfolios.

Specialised Lending

– The expected loss reduction of £0.3bn to £0.6bn and the SCRA reduction of £0.3bn to £0.4bn is primarily driven by asset reductions, active portfolio management including disposals and write-offs of defaulted exposures.

Fair value adjustments

– Fair value adjustments applied within the EEL calculation have reduced by £0.1bn to £0.2bn due to the fair value unwind over the course of the year.

Other adjustments

– Other adjustments have increased by £0.3bn following revised guidance issued by the EBA relating to prudent valuation adjustments.

Pillar 1 Capital requirements: Credit risk – securitisation

This section details Lloyds Banking Group's securitisation profile.

- The Group operates in the securitisation market in the following capacity:

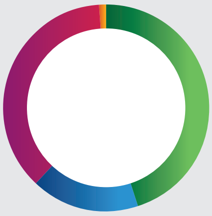
  As an originator, sponsor of an asset-backed commercial paper conduit and as an arranger of and an investor in third party securitisations. It also holds a small portfolio of ABS trading book securitisation positions.

  As a provider of liquidity and funding facilities to own originated and sponsored positions as well as to third parties.
- Securitisations represent a small proportion (2.0%) (2016: 1.8%) of the Group's total risk-weighted assets
- Banking Book securitisation exposures decreased by £1.1bn in the year primarily as a result of a net reduction in investment grade investor positions, partially offset by retained positions in new originated capital efficient securitisation transactions. Risk-weighted assets increased by £0.2bn primarily due to the new originated securitisation transactions, offset by the sales, maturities and amortisation across investor and sponsor positions.

% Exposure by securitisation type

Originated 30%	(2016: 24%)
Sponsored 32%	(2016: 33%)
Invested 37%	(2016: 42%)
Trading Book 1%	(2016: 1%)

% Risk-weighted assets by securitisation type



Originated 45%	(2016: 33%)
Sponsored 17%	(2016: 20%)
Invested 37%	(2016: 46%)
Trading Book 1%	(2016: 1%)

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 an asset-backed commercial paper (ABCP) conduit 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. In addition, the Group also holds a small portfolio of ABS trading book securitisation positions.

Banking book securitisation strategy and roles

The Group's objectives in relation to banking book securitisations 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 uses securitisation as a means of managing its balance sheet. Although primarily a funding tool, the Group also uses originated securitisations to generate capital efficiencies through the use of synthetic loan securitisations which involve the use of credit derivatives.

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. Traditional securitisations are typically funding driven transactions where the most junior tranches are retained by the Group meaning 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.

Synthetic originated securitisations work in a similar way to the traditional version except that the economic risk of the assets is transferred using credit derivatives. In certain cases the Group will retain the risk on the senior tranches.

Where capital efficiency is sought, a test of significant risk transfer (SRT) is required. Passing the test allows the capital required on the underlying exposures to be replaced by the lower capital requirements of the retained positions in the securitisation.

Origination activities mainly extend around the Group's retail and commercial lending portfolios.

As a sponsor the Group manages and supports, through the provision of liquidity facilities, an ABCP conduit (Cancara) that invests in client receivables. Liquidity facilities provided to Cancara are risk-weighted using the internal assessment approach (IAA). The Group also holds some commercial paper (CP) issued by Cancara.

All the external assets in Cancara are consolidated for accounting purposes in the Group's financial statements, following similar accounting policies to those established for originated securitisations.

As an investor the Group invests directly in third party ABS and notes and provides liquidity facilities to other third party securitisations. Invested securitisation positions are risk-weighted using the ratings based approach (RBA).

Trading book securitisation strategy and roles

The Group's ABS trading book consists primarily of investments in third party securitisation positions and to a lesser extent, in the Group's sponsored securitisations.

The main objectives of the ABS trading book are;

- 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 key risks attached to the Group's holding of trading book securitisation positions include price risk, credit risk, event risk, interest rate fluctuations, moral hazard and servicer risk. Liquidity risk is considered to be low as the Group's ABS trading book is relatively small, with maximum holding period limits and with positions held for the short term.

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.

As the Group's portfolio of trading book securitisation positions is relatively small (£289m exposure, £28m risk-weighted assets) in the context of both the overall trading book and the Group's banking book securitisation positions, the Group has elected to provide only limited disclosure around its trading book securitisation positions as permitted by CRR Article 432 and in accordance with related EBA guidelines.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Summary analysis

An analysis of securitisation exposures by book, 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 49: Summary of securitisation exposures and capital requirements

Securitisation type and risk weight approach	2017 Exposure value[1] £m	2017 Risk-weighted assets[2] £m	2017 Capital requirement £m	2017 Deduction from capital[3] £m	2016 Exposure value[1] £m	2016 Risk-weighted assets[2] £m	2016 Capital requirement £m	2016 Deduction from capital[3] £m
Originated:								
Ratings Based approach (RBA)	**6,655**	**1,592**	**127**	**4**	5,321	1,055	85	–
Standardised approach	**1,067**	**244**	**20**	**–**	1,184	268	21	–
Supervisory formula approach (SFA)	**72**	**46**	**4**	**–**	–	–	–	–
Sponsored and invested:								
Internal assessment approach (IAA)	**8,574**	**731**	**58**	**–**	9,129	825	66	–
Ratings based approach (RBA)	**9,789**	**1,575**	**126**	**187**	11,616	1,823	146	217
Total banking book[4]	**26,157**	**4,188**	**335**	**191**	27,250	3,971	318	217
Trading book – specific interest rate market risk	**289**	**28**	**2**	**–**	122	17	1	–
Total trading book	**289**	**28**	**2**	**–**	122	17	1	–

1 Banking book exposure value 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. Trading book exposure value is defined as the sum of the net long and net short positions as per CRD IV rules.

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 and are stated net of SCRAs.

4 Excludes counterparty credit risk securitisation positions, further information on which can be found on page 92.

Key movements

Banking book

– Originator: The increase during the year is the result of new capital efficient commercial asset backed securitisation transactions.

– Sponsor: The reduction in exposure reflects the net reduction in the liquidity facilities provided to the conduit programme. This is as a result of reduced and matured positions, offset by new client transactions.

– Investor: The reduction in exposure is primarily due to the termination of investment grade investor positions in addition to sales and amortisations of other positions during the year, partially offset by an increase in facilities to third party clients and a commitment to provide a new investment grade securitisation financing facility.

Trading book

– Trading book exposures remained low throughout the year.

Securitisation programmes and activity

The Group's securitisation programmes are predominantly funding or collateral creation transactions, including all of the residential mortgage programmes. 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 outlined in Note 18 (Securitisations and Covered Bonds) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

No securitisation transactions undertaken during the year were recognised as sales (2016: portfolio of commercial assets were sold to SE with resultant gain for the Group of £1.7m). In 2017 the Group originated several new capital efficient commercial asset backed securitisation transactions.

Re-securitisation

Re-securitisation transactions 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. The Group has no originated re-securitisation positions in either its banking or trading book.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Risks inherent in banking book securitised assets

Where the Group acts as originator its securitisation programmes primarily include 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 various assets within the Group's commercial securitisations.

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 UK 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, 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 rates 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.

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 assets. 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.

Monitoring changes in the credit risk of ABS portfolios

ABS exposures reside primarily in the residual run-off portfolio managed by Commercial Banking Client Asset Management. The Group also holds some small ABS exposures for liquidity coverage ratio (LCR) purposes which are managed by the Liquid Asset Portfolio team. Each team is therefore responsible for the monitoring of changes in the credit risk of ABS within its portfolio.

The credit process is the same across portfolios: 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 Specialist Finance Credit (SFC) team provides an independent risk oversight for ABS credit reviews. It provides each ABS transaction with a credit risk classification (ranging from good to substandard), as well as sanctioning credit limits either locally or by referral to the credit committee.

Furthermore, additional monitoring measures are applied: quarterly watch list (including a review of downgraded bonds), quarterly preparation of International Accounting Standards (IAS) 39 attestations, stress testing of portfolios and in the case of the Liquid Asset Portfolio a quarterly risk review forum is also conducted.

Banking and trading book securitisation analysis

The table below discloses the Group's retained and purchased positions across the banking and trading book by exposure type and role.

Table 50: Value of exposures of retained and purchased positions in the banking and trading book by exposure type

	2017						2016					
	Banking book				Trading book[1]		Banking book				Trading book[1]	
Exposure type	Originator £m	Sponsor £m	Investor £m	Total £m	Investor £m	Total £m	Originator £m	Sponsor £m	Investor £m	Total £m	Investor £m	Total £m
Retail (total) of which	–	6,098	6,363	12,461	271	271	–	5,223	7,920	13,143	52	52
residential mortgage	–	472	4,459	4,932	271	271	–	548	6,404	6,952	49	49
credit card	–	460	–	460	–	–	–	308	–	308	3	3
leases and receivables	–	3,759	–	3,759	–	–	–	2,576	–	2,576	–	–
other retail exposures	–	1,406	1,903	3,310	–	–	–	1,791	1,516	3,307	–	–
Commercial (total) of which	7,794	2,476	3,426	13,697	18	18	6,505	3,906	3,696	14,107	70	70
loans to corporates or SMEs	6,462	770	1,241	8,474	–	–	4,997	1,492	1,362	7,851	–	–
social housing associations	1,332	–	–	1,332	–	–	1,508	–	–	1,508	–	–
commercial mortgage	–	–	1,293	1,293	–	–	–	–	1,366	1,366	–	–
leases and receivables	–	1,487	822	2,308	11	11	–	2,414	872	3,286	59	59
other commercial	–	219	70	290	7	7	–	–	91	91	11	11
re-securitisation	–	–	–	–	–	–	–	–	5	5	–	–

1 All trading book securitisations are traditional securitisations.

Pillar 1 Capital requirements: Credit risk – securitisation continued

ORIGINATED SECURITISATIONS

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 SRT tests when securitised. Meeting these tests allows the retained positions in the securitisations to be included within regulatory calculations, and the risk-weighted assets on the exposures underlying the securitisation to be removed. Where the minimum requirements for recognition of SRT are not met, the underlying exposures remain part of the relevant exposure class and are risk-weighted accordingly.

Capital requirements in relation to originated securitisation positions are primarily determined under the RBA or the Standardised approach, with limited use made of Supervisory Formula Approach. Where appropriate, the Group utilises the ratings services of several ECAIs, including Standard & Poor's, Moody's and Fitch, to rate securitisation transactions and retained or purchased positions for risk weight allocation purposes under both the RBA and Standardised approach. For synthetic securitisations any maturity mismatch between the credit protection and securitised exposures has been treated in line with CRR Article 250.

On a regulatory basis, the gross securitised exposures in relation to originated securitisations where significant risk transfer is achieved amounted to £8.6bn (2016: £7.1bn) comprising synthetic originated securitisations. An analysis is provided in the table below together with the amount of impaired exposures and past due but not impaired exposures.

Table 51: Analysis of gross securitised exposures on a regulatory basis

	2017			2016		
	Gross securitised exposure			Gross securitised exposure		
	Synthetic £m	Impaired exposures £m	Past due but not impaired exposures £m	Synthetic £m	Impaired exposures £m	Past due but not impaired exposures £m
Commercial						
social housing associations	1,386	–	–	1,562	–	–
loans to corporates or SMEs	7,204	86	6	5,527	48	3
Total	8,590	86	6	7,089	48	3

The gross charge to the income statement for the year to 31 December 2017 in respect of losses attributed to the gross securitised exposures noted above amounted to £9.6m (2016: £35.8m).

Originated securitisations subject to the RBA

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 2017, securitisation positions arising from origination activities and risk-weighted under the RBA amounted to £6.7bn (2016: £5.3bn), generating a capital requirement of £127m (2016: £85m). An analysis of these positions, by risk weight category, is provided in the table below.

Table 52: Analysis of originated positions under the RBA by risk weight category

		Securitisation positions				Total 2017		Total 2016	
		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%)	4,795	45	229	3	5,024	48	3,995	25
AA	(8%, 15%)	–	–	632	11	632	11	474	6
A+	(10%, 18%)	–	–	338	5	338	5	301	5
A	(12%, 20%)	–	–	69	1	69	1	77	1
A-	(20%, 35%)	–	–	61	2	61	2	52	1
BBB+	(35%, 50%)	–	–	205	9	205	9	156	7
BBB	(60%, 75%)	–	–	68	4	68	4	40	3
BBB-	(100%, 100%)	–	–	56	5	56	5	99	8
BB+	(250%, 250%)	–	–	196	39	196	39	121	26
BB	(425%, 425%)	–	–	5	2	5	2	3	1
BB-	(650%, 650%)	–	–	1	1	1	1	3	2
Below BB- or unrated	Deduction	–	–	–	–	–	–	–	–
Total credit risk exposure/capital requirement[2]		4,795	45	1,860	82	6,655	127	5,321	85

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 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.

As at 31 December 2017, there was a de-minimis non senior securitisation position arising from origination activities held and risk-weighted under the SFA amounting to £72bn (2016: £nil), generating a capital requirement of £4m.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Originated Securitisations subject to the Standardised approach

The Standardised approach utilises a set of defined risk weights prescribed by CRD IV rules. The appropriate risk-weight is dependent on the rating of the position and its classification as a securitisation position or re-securitisation position. As at 31 December 2017, securitisation positions arising from origination activities and risk-weighted under the Standardised approach amounted to £1.1bn (2016: £1.2bn) generating a capital requirement of £20m (2016: £21m). An analysis of these positions, by risk weight category, is provided in the table below.

Table 53: Analysis of originated positions under the Standardised approach by risk weight category

		Total 2017		Total 2016	
		Securitisation positions		Securitisation positions	
Fitch equivalent rating and standardised approach risk weight		Exposure £m	Cap req £m	Exposure £m	Cap req £m
AAA to AA-	(20%)	**994**	**17**	1,111	18
A+ to A-	(50%)	**55**	**2**	55	2
BBB+ to BBB-	(100%)	**18**	**1**	18	1
BB+ to BB-	(350%)	**–**	**–**	–	–
Below B+ or unrated	Deduction	**–**	**–**	–	–
Total credit risk exposure/capital requirement[1]		**1,067**	**20**	1,184	21

1 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.

Accounting treatment

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 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

– substantially all of the risks and rewards associated with 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 mortgages and commercial banking loans are not typically derecognised because the Group retains substantially all the risks and rewards associated with the underlying portfolios of assets. In addition, for many of these assets, the Group has not transferred the contractual rights to receive the cash flows or assumed a contractual obligation to pay the cash flows to a third party.

Where internal transactions between the banking group and the insurance group achieve accounting derecognition from the underlying banking subsidiary balance sheet, the assets continue to be fully consolidated from a Group perspective but may achieve derecognition under the regulatory scope of consolidation. Synthetic securitisations, where credit derivatives or financial guarantees 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 protection 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 2017 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 Note 2(E) (Accounting Policies: Financial Assets and Liabilities) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

For those positions measured at fair value, further details on the valuation methodologies applied are outlined in Note 48(2) (Financial Instruments: Fair Value Measurement) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Use of credit derivatives and guarantees

Synthetic securitisations, covering social housing associations and other loans to corporates and SMEs, involve the provision of protection to the Group through a combination of financial guarantees and credit protection agreements with the SE established under the transactions that results in a net protected position of a junior tranche of the securitised portfolio. The SE issues CLNs to pass on the risk associated with the net protected position to third party investors who primarily 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 £350m at 31 December 2017 (2016: £350m) with £40m of the facility having been drawn down (2016: £82m).

SPONSORED AND INVESTED SECURITISATIONS

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 2017	$20.0bn/$6.0bn (£14.8bn/£4.4bn)
Conduit structure	Fully supported multi-seller
Credit enhancement	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. During 2016 the addition of new client transactions was offset by the movement of a number of transactions to the balance sheet. Additionally, certain liquidity facilities supporting the program were drawn to provide funding alongside the proceeds of ABCP issuance. During 2017 some liquidity facilities continued to be drawn to provide funding alongside ABCP issuance, but there were no additional transactions transferred to the balance sheet.

Cancara Assets

All the external assets in the conduit 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 Note 19 (Structured Entities) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Capital assessment

With regard to sponsored activities, the Group has approval to utilise the 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 then feeds the RBA 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 PD 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 Securitised Products Group monitors rating agency updates and undertakes assessment 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 contributes towards 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.

The sponsored 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 Standard & Poor's 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 Group Model Governance Policy, the Group undertakes an Annual Review 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.

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 54: Analysis of sponsored positions by risk weight category

S&P equivalent rating and IAA risk weight		2017 Exposure £m	2017 Capital requirement £m	2016 Exposure £m	2016 Capital requirement £m
On Balance Sheet					
AAA	7%	**911**	**5**	1,410	8
AA+ to AA-	8%	**593**	**4**	959	7
A+	10%	**–**	**–**	–	–
A	12%	**368**	**4**	683	7
A-	20%	**–**	**–**	–	–
BBB	60%	**–**	**–**	–	–
Off Balance Sheet					
AAA	7%	**4,045**	**24**	2,743	16
AA+ to AA-	8%	**1,838**	**13**	1,989	14
A+	10%	**–**	**–**	154	1
A	12%	**811**	**8**	1,175	12
A-	20%	**–**	**–**	–	–
BBB	60%	**8**	**–**	16	1
Total credit risk exposure/capital requirement		**8,574**	**58**	9,129	66

Direct investments and liquidity facilities

In addition to sponsoring an ABCP conduit, the Group has invested directly in third party ABS and notes and is a provider of liquidity facilities to other third party securitisation.

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 (AFS) or at fair value through profit and loss. Further details on the Group's holding of ABS are presented on pages 244 and 245 in Note 51(c) (Financial Risk Management: Credit Quality of Assets) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Credit risk – securitisation continued

Invested securitisations subject to the RBA

As at 31 December 2017, securitisation positions relating to the Group's direct investments in third party ABS and notes, commitment to provide a new investment grade securitisation financing facility and the provision of liquidity facilities to third party securitisations, risk weighted under the RBA, amounted to £9.8bn (2016: £11.6bn), generating a capital requirement of £126m (2016: £146m). An analysis of these positions, by risk weight category, is provided in the table below.

Table 55: Analysis of invested positions by risk weight category

		Securitisation positions 2017						Re-Securitisation positions 2017		2017		2016	
		Senior		Non-senior		Tranches backed by non granular pools		Senior		Total		Total	
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%)	**3,529**	**21**	**–**	**–**	**29**	**–**	**–**	**–**	**3,558**	**21**	3,598	21
AA	(8%, 15%, 25%, 25%)	**608**	**3**	**121**	**2**	**419**	**9**	**–**	**–**	**1,148**	**14**	693	11
A+	(10%, 18%, 35%, 35%)	**–**	**–**	**353**	**5**	**97**	**3**	**–**	**–**	**450**	**8**	304	6
A	(12%, 20%, 35%, 40%)	**432**	**4**	**–**	**–**	**1**	**–**	**–**	**–**	**433**	**4**	553	6
A-	(20%, 35%, 35%, 60%)	**122**	**2**	**41**	**1**	**–**	**–**	**–**	**–**	**163**	**3**	249	6
BBB+	(35%, 50%, 50%, 100%)	**–**	**–**	**114**	**5**	**–**	**–**	**–**	**–**	**114**	**5**	45	2
BBB	(60%, 75%, 75%, 150%)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	107	6
BBB-	(100%, 100%, 100%, 200%)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	50	4
BB+	(250%, 250%, 250%, 300%)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	3	1
BB	(425%, 425%, 425%, 500%)	**–**	**–**	**–**	**–**	**1**	**–**	**–**	**–**	**1**	**–**	–	–
BB-	(650%, 650%, 650%, 750%)	**–**	**–**	**–**	**–**	**17**	**9**	**–**	**–**	**17**	**9**	–	–
Below BB- or unrated	Deduction	**–**	**–**	**–**	**–**	**180**	**–**	**–**	**–**	**180**	**–**	187	–
Off Balance Sheet													
AAA	(7%, 12%, 20%, 20%)	**1,558**	**9**	**–**	**–**	**569**	**10**	**–**	**–**	**2,127**	**19**	3,854	28
AA	(8%, 15%, 25%, 25%)	**578**	**4**	**92**	**1**	**115**	**2**	**–**	**–**	**785**	**8**	946	10
A+	(10%, 18%, 35%, 35%)	**–**	**–**	**–**	**–**	**148**	**4**	**–**	**–**	**148**	**4**	148	4
A	(12%, 20%, 35%, 40%)	**130**	**1**	**77**	**1**	**291**	**9**	**–**	**–**	**498**	**11**	596	13
A-	(20%, 35%, 35%, 60%)	**–**	**–**	**–**	**–**	**156**	**5**	**–**	**–**	**156**	**5**	172	6
BBB+	(35%, 50%, 50%, 100%)	**–**	**–**	**–**	**–**	**76**	**3**	**–**	**–**	**76**	**3**	52	2
BBB	(60%, 75%, 75%, 150%)	**–**	**–**	**32**	**2**	**46**	**3**	**–**	**–**	**78**	**5**	201	13
BBB-	(100%, 100%, 100%, 200%)	**–**	**–**	**–**	**–**	**28**	**2**	**–**	**–**	**28**	**2**	34	3
BB+	(250%, 250%, 250%, 300%)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	–	–
BB	(425%, 425%, 425%, 500%)	**–**	**–**	**–**	**–**	**9**	**3**	**–**	**–**	**9**	**3**	11	4
BB-	(650%, 650%, 650%, 750%)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	–	–
Below BB- or unrated	Deduction	**–**	**–**	**–**	**–**	**7**	**–**	**–**	**–**	**7**	**–**	30	–
Total		**6,956**	**45**	**831**	**18**	**2,189**	**63**	**–**	**–**	**9,976**	**126**	11,833	146
Deduction from capital										**(187)**	**–**	(217)	–
Total credit risk exposure/ capital requirement[2]										**9,789**	**126**	11,616	146

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.

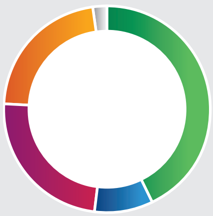
2 Total credit risk exposure is defined as the aggregate of the Group's gross retained or purchased positions, excluding those positions rated below BB- or that are unrated and therefore deducted from capital. Capital requirements are stated net of SCRA's, where applicable.

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.

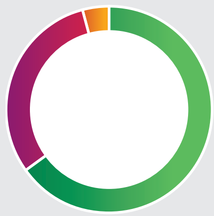
- The Group's counterparty credit risk strategy is to use collateral agreements and other risk management techniques, such as central clearing, to mitigate risk exposure.
- Counterparty credit risk (including credit valuation adjustment (CVA)) represents a small proportion (3.7%) (2016: 4.5%) of the Group's total risk-weighted assets.
- Counterparty credit risk exposure increased by 32% to £40.0bn mainly due to Bank of England repo and Term Funding Scheme increases in 2017.
- Risk-weighted assets decreased by 18% to £7.9bn.

IRB exposures



Corporate – main 43%	(2016: 45%)
Central governments or central banks 9%	(2016: 9%)
Institutions 24%	(2016: 26%)
Corporate – specialised lending 22%	(2016: 18%)
Securitisation positions 2%	(2016: 2%)

Standardised exposures



Central governments or central banks 65%	(2016: 28%)
International organisations nil%	(2016: 2%)
Institutions 31%	(2016: 62%)
Corporates 4%	(2016: 8%)

Table 56: Risk-weighted assets flow statements of CCR exposures[1,2]

	RWA amounts £m	Capital requirements £m
Risk-weighted assets as 31 December 2016	**9,623**	**770**
Asset Size	(403)	(32)
Asset quality	(222)	(18)
Model updates	–	–
Methodology and policy	(431)	(34)
Acquisitions and disposals	(26)	(2)
Foreign exchange movements	(656)	(53)
Other	–	–
Risk-weighted assets as at 31 December 2017	**7,885**	**631**

1 There are no exposures under the Internal Model Method requiring analysis under EBA template CCR7. The Group has elected to include the above risk-weighted assets flow statement of total CCR as a supplementary disclosure.

2 CCR includes movements in contributions to the default fund of central counterparties and movements in credit valuation adjustment risk.

Key movements

– Counterparty credit risk and CVA risk-weighted assets reductions of £1.7bn were mainly driven by foreign exchange movements, reductions in position levels and updates to calculation methodology following clarification of the regulatory approach and other movements.

Pillar 1 Capital requirements: Counterparty credit risk continued

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 derivatives 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, which is largely applied to central governments or central banks and institution exposures; government securities and guarantees), break clauses and netting. A significant amount of derivative exposure is cleared at Qualified Central Counterparties (QCCPs), which replaces exposure to individual counterparties with an exposure against the Central Counterparty (CCP).

Policy is set governing types of acceptable collateral and haircuts, in line with industry practice.

Collateral arrangements are governed by standard agreements (such as Global Master Repurchase Agreements and Credit Support Annexes (CSA) to International Swaps and Derivative Association (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. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex (CSA) in conjunction with the ISDA Master Agreement. Derivative transactions with non-bank customers are not usually supported by a CSA.

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 offset on a portfolio by 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.

MASTER NETTING AGREEMENTS

It is credit policy that a Group approved master netting agreement must be used for all derivative and traded property transactions and must be in place prior to trading. Any exceptions must be approved by the credit sanctioner. 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, within relevant jurisdictions and for appropriate counterparty types they do reduce the credit risk to the extent that, if an event of default occurs, all trades with the counterparty may be 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.

COLLATERAL REQUIREMENTS IN THE EVENT OF A DOWNGRADE IN CREDIT RATING

Internal stress testing results at 31 December 2017 showed that the banking business had liquidity resources representing 142 per cent of modelled outflows from all wholesale funding sources, retail and corporate deposits, intraday requirements and rating dependent contracts under the Group's most severe liquidity stress scenario.

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 £1.1bn of cash over a period of up to one year, £2.0bn of collateral posting related to customer financial contracts and £5.9bn of collateral posting associated with secured funding.

CORRELATION (WRONG WAY) RISK

The Group seeks to avoid correlation or wrong way risk where possible. Under repurchase (repo) policy, the issuer of the collateral and the repo counterparty should be neither the same nor connected. The same rule applies for derivatives. The Risk Division has 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).

DERIVATIVE VALUATION ADJUSTMENTS

Details on the application of derivative valuation adjustments, including Credit and Debit Valuation Adjustments (CVA and DVA), are provided in Note 48 (Financial instruments) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

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 2017 was £40.0bn (2016: £30.3bn). An analysis by measurement approach is presented in the table below.

Table 57: CCR: analysis by measurement approach

	2017 Credit risk exposure[1] £m	2016 Credit risk exposure[1] £m
CCR standardised approach	–	–
CCR mark-to-market method	10,669	14,526
CCR internal model method	–	–
SFT comprehensive approach	20,597	7,815
CCR central counterparty	8,556	7,752
Contributions to the default fund of a central counterparty	201	165
Total	**40,023**	**30,258**

1 Counterparty credit risk exposures are stated on an EAD post CRM basis throughout this section, unless otherwise stated.

Key movements

– Mark-to-market exposure reduced by £3.9bn driven by yield curve impacts, lower trading volume and sterling foreign exchange movements.
– SFT exposure increased by £12.8bn mainly due to Bank of England repo and Term Funding Scheme increases in 2017.

Table 58: Analysis of CCR exposure by approach (CCR1)[3]

The methods and parameters used to calculate the CCR regulatory requirements are presented in the table below.

	2017						
	Notional £m	Replacement cost/current market value[1] £m	Potential future credit exposure[1] £m	Effective expected positive exposure (EEPE) £m	Multiplier x	EAD Post CRM[2] £m	RWAs £m
Mark to market		6,267	4,314			10,669	5,481
Original exposure	–					–	–
Standardised approach		–		–	–	–	–
IMM (for derivatives and SFTs)				–	–	–	–
of which: securities financing transactions				–	–	–	–
of which: derivatives and long settlement transactions				–	–	–	–
of which: from contractual cross-product netting				–	–	–	–
Financial collateral simple method (for SFTs)						–	–
Financial collateral comprehensive method (for SFTs)						20,597	403
VaR for SFTs						–	–
Total	–	6,267	4,314	–	–	31,266	5,884

1 Replacement cost and PFE have been reported on a net basis where a netting agreement is in place (collateral is deducted from the replacement cost).
2 Exposure values of £2.7bn subject to CVA are embedded in this section, the CVA risk-weighted assets are excluded from this table. For CVA risk-weighted assets please refer to Table 60.
3 CCP exposures and charges are excluded from this table. For CCP balances please refer to Table 59: Exposures to CCPs (CCR8).

Pillar 1 Capital requirements: Counterparty credit risk continued

Table 59: Exposures to CCPs (CCR8)

An analysis of the group's exposures to CCPs and related capital requirements are shown in this table.

	2017 EAD post CRM £m	2017 RWAs £m
Exposures to QCCPs (total)	**8,757**	**599**
Exposures for trades at QCCPs (excluding initial margin and default fund contributions); of which	8,534	171
(i) OTC derivatives	7,592	152
(ii) Exchange-traded derivatives	417	8
(iii) SFTs	524	10
(iv) Netting sets where cross-product netting has been approved	–	–
Segregated initial margin	–	
Non-segregated initial margin	22	–
Prefunded default fund contributions	201	428
Alternative calculation of own funds requirements for exposures		–
Exposures to non-QCCPs (total)	–	–
Exposures for trades at non-QCCPs (excluding initial margin and default fund contributions); of which	–	–
(i) OTC derivatives	–	–
(ii) Exchange-traded derivatives	–	–
(iii) SFTs	–	–
(iv) Netting sets where cross-product netting has been approved	–	–
Segregated initial margin	–	
Non-segregated initial margin	–	–
Prefunded default fund contributions	–	–
Unfunded default fund contributions	–	–

Table 60: Credit valuation adjustment (CVA) capital charge (CCR2)[1]

	2017 Exposure value £m	2017 RWA £m	2016 Exposure value £m	2016 RWA £m
Total portfolios subject to the Advanced CVA capital charge	–	–	–	–
(i) VaR component (including the 3×multiplier)	–	–	–	–
(ii) Stressed VaR component (including the 3×multiplier)	–	–	–	–
All portfolios subject to the Standardised Method	2,657	1,402	4,463	864
Based on Original Exposure Method	–	–	–	–
Total subject to the CVA capital charge	**2,657**	**1,402**	**4,463**	**864**

1 The CVA exposures disclosed in this table are embedded in the exposures reported in Table 58: Analysis of CCR exposure by approach (CCR1).

Key movements

– Exposure values subject to CVA have reduced by £1.8bn due to yield curve impacts, lower trading volume and sterling foreign exchange movements. The increase in risk-weighted assets is primarily driven by hedging activity in the year.

Pillar 1 Capital requirements: Counterparty credit risk continued

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY EXPOSURE CLASS

An analysis of counterparty credit risk exposures by exposure class, is presented in the table below.

Table 61: CCR: analysis by exposure class

	2017 Credit risk exposure £m	2017 Risk weighted assets £m	2016 Credit risk exposure £m	2016 Risk weighted assets £m
Foundation IRB approach				
Corporate – Main	**5,109**	**2,218**	7,902	3,213
Corporate – SME	**3**	**4**	–	–
Central governments or central banks	**987**	**43**	1,599	79
Institutions	**2,850**	**1,118**	4,420	1,828
Other IRB approach				
Corporate – Specialised lending[1]	**2,569**	**1,890**	3,206	2,453
Securitisation positions[2]	**283**	**107**	343	118
Total IRB approach	**11,802**	**5,381**	17,470	7,691
Exposures subject to the standardised approach				
Central governments or central banks	**18,319**	**–**	3,597	3
Multilateral development banks	**62**	**–**	19	–
International organisations	**65**	**–**	209	–
Institutions	**8,574**	**184**	7,761	158
Corporates	**1,000**	**490**	1,037	567
Total standardised approach	**28,020**	**674**	12,623	728
Contributions to the default fund of a Central Counterparty	**201**	**428**	165	340
Credit valuation adjustment[3]		**1,402**		864
Total	**40,023**	**7,885**	30,258	9,623

1 Exposures subject to the IRB Supervisory Slotting Approach.

2 No positions relating to counterparty credit risk securitisation positions were deducted from capital (2016: £nil).

3 CVA exposure values of £2.7bn (2016: £4.5bn) are embedded in the exposure class analysis above.

Key movements

– IRB exposures and risk-weighted assets reduced by £5.7bn and £2.3bn respectively driven by yield curve impacts, lower trading volume and sterling foreign exchange movements.

– Standardised exposures increased by £15.4bn mainly due to Bank of England repo and Term Funding Scheme increases in 2017.

– CVA risk-weighted assets have increased by £0.5bn primarily due to hedging activity in the year.

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.

Throughout this section 'RWA density' represents the average risk weight.

Table 62: IRB – CCR exposure by portfolio and PD scale – Corporate Main (CCR4)

	2017						
PD Scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average Maturity (years)	RWA	RWA density
Corporate – Main	£m	%		%		£m	%
0.00 to <0.15	3,213	0.07%	711	45.0%	3.4	1,003	31.2%
0.15 to <0.25	789	0.18%	254	45.0%	2.8	379	48.1%
0.25 to <0.50	751	0.33%	766	45.0%	2.3	442	58.9%
0.50 to <0.75	84	0.63%	129	45.0%	3.2	76	90.8%
0.75 to <2.50	102	1.21%	240	45.0%	2.7	110	108.0%
2.50 to <10.00	90	3.30%	109	45.0%	2.2	123	136.6%
10.00 to <100.00	41	13.46%	4	45.0%	1.0	85	204.8%
100.00 (Default)	40	100.00%	10	45.0%	2.8	–	–
Sub-total	**5,109**	**1.10%**	**2,223**	**45.0%**	**3.1**	**2,218**	**43.4%**

	2016						
PD Scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average Maturity (years)	RWA	RWA density
Corporate – Main	£m	%		%		£m	%
0.00 to <0.15	4,783	0.07%	624	45.0%	3.2	1,336	28.0%
0.15 to <0.25	767	0.18%	240	45.0%	3.0	375	49.0%
0.25 to <0.50	1,831	0.33%	774	45.0%	1.7	948	51.8%
0.50 to <0.75	103	0.63%	256	45.0%	2.5	84	81.2%
0.75 to <2.50	234	1.20%	403	45.0%	2.7	249	106.3%
2.50 to <10.00	137	4.50%	189	45.0%	3.1	220	160.2%
10.00 to <100.00	0	31.62%	27	45.0%	1.7	1	210.6%
100.00 (Default)	47	100.00%	14	45.0%	2.3	–	–
Sub-total	7,902	0.85%	2,527	45.0%	2.8	3,213	40.7%

Pillar 1 Capital requirements: Counterparty credit risk continued

Table 63: IRB – CCR exposures by portfolio and PD scale – Central governments or central banks (CCR4)

	2017						
PD Scale	**EAD post CRM**	**Average PD**	**Number of obligors**	**Average LGD**	**Average Maturity (years)**	**RWA**	**RWA density**
Central governments or central banks	**£m**	**%**		**%**		**£m**	**%**
0.00 to <0.15	**986**	**0.04%**	**13**	**45.0%**	**0.1**	**42**	**4.3%**
0.15 to <0.25	**–**	**–**	**–**	**–**	**–**	**–**	**–**
0.25 to <0.50	**–**	**–**	**–**	**–**	**–**	**–**	**–**
0.50 to <0.75	**–**	**–**	**–**	**–**	**–**	**–**	**–**
0.75 to <2.50	**–**	**–**	**–**	**–**	**–**	**–**	**–**
2.50 to <10.00	**–**	**–**	**–**	**–**	**–**	**–**	**–**
10.00 to <100.00	**1**	**12.00%**	**1**	**45.0%**	**1.0**	**1**	**100.0%**
100.00 (Default)	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Sub-total	**987**	**0.04%**	**14**	**45.0%**	**0.1**	**43**	**4.3%**

	2016						
PD Scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average Maturity (years)	RWA	RWA density
Central governments or central banks	£m	%		%		£m	%
0.00 to <0.15	1,599	0.04%	11	45.0%	–	79	5.0%
0.15 to <0.25	–	–	–	–	–	–	–
0.25 to <0.50	–	–	–	–	–	–	–
0.50 to <0.75	–	–	–	–	–	–	–
0.75 to <2.50	–	–	–	–	–	–	–
2.50 to <10.00	–	–	–	–	–	–	–
10.00 to <100.00	–	–	–	–	–	–	–
100.00 (Default)	–	–	–	–	–	–	–
Sub-total	1,599	0.04%	11	45.0%	–	79	5.0%

Pillar 1 Capital requirements: Counterparty credit risk continued

Table 64: IRB – CCR exposure by portfolio and PD scale – Institutions (CCR4)

	2017						
PD Scale	**EAD post CRM**	**Average PD**	**Number of obligors**	**Average LGD**	**Average Maturity (years)**	**RWA**	**RWA density**
Institutions	**£m**	**%**		**%**		**£m**	**%**
0.00 to <0.15	**2,609**	**0.04%**	**239**	**45.0%**	**3.7**	**912**	**34.9%**
0.15 to <0.25	**168**	**0.18%**	**45**	**45.0%**	**4.3**	**129**	**76.9%**
0.25 to <0.50	**65**	**0.30%**	**36**	**45.0%**	**4.0**	**62**	**95.5%**
0.50 to <0.75	**3**	**0.63%**	**8**	**45.0%**	**2.0**	**2**	**74.7%**
0.75 to <2.50	**2**	**1.57%**	**9**	**45.0%**	**1.1**	**2**	**95.7%**
2.50 to <10.00	**–**	**2.61%**	**4**	**45.0%**	**1.1**	**–**	**138.9%**
10.00 to <100.00	**4**	**27.79%**	**3**	**45.0%**	**3.4**	**12**	**289.9%**
100.00 (Default)	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Sub-total	**2,850**	**0.10%**	**344**	**45.0%**	**3.7**	**1,118**	**39.2%**

	2016						
PD Scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average Maturity (years)	RWA	RWA density
Institutions	£m	%		%		£m	%
0.00 to <0.15	3,905	0.05%	264	45.0%	3.4	1,397	35.8%
0.15 to <0.25	312	0.18%	40	45.0%	4.6	252	80.8%
0.25 to <0.50	182	0.32%	50	45.0%	3.6	160	88.0%
0.50 to <0.75	10	0.63%	7	45.0%	1.4	8	86.4%
0.75 to <2.50	9	1.04%	8	45.0%	1.1	7	80.5%
2.50 to <10.00	1	4.20%	2	45.0%	1.9	2	141.9%
10.00 to <100.00	1	31.00%	1	45.0%	5.0	2	317.2%
100.00 (Default)	–	–	–	–	–	–	–
Sub-total	4,420	0.08%	372	45.0%	3.5	1,828	41.3%

Pillar 1 Capital requirements: Counterparty credit risk continued

Table 65: CCR corporate exposures subject to supervisory slotting

2017 Specialised lending

Regulatory Categories	Remaining maturity	On-balance sheet amount £m	Off-balance sheet amount £m	RW %	Exposure amount £m	RWA £m
1) Strong	Less than 2.5 years	105	–	50%	106	53
	Equal to or more than 2.5 years	1,956	–	70%	1,802	1,261
2) Good	Less than 2.5 years	90	–	70%	90	63
	Equal to or more than 2.5 years	442	–	90%	465	419
3) Satisfactory	Less than 2.5 years	1	–	115%	1	1
	Equal to or more than 2.5 years	67	–	115%	81	93
4) Weak	Less than 2.5 years	–	–	250%	–	–
	Equal to or more than 2.5 years	–	–	250%	–	–
5) Default	Less than 2.5 years	–	–	0%	–	–
	Equal to or more than 2.5 years	13	–	0%	24	–
Total	Less than 2.5 years	196	–		197	117
	Equal to or more than 2.5 years	2,478	–		2,372	1,773

2016 Specialised lending

Regulatory Categories	Remaining maturity	On-balance sheet amount £m	Off-balance sheet amount £m	RW %	Exposure amount £m	RWA £m
1) Strong	Less than 2.5 years	94	–	50%	95	47
	Equal to or more than 2.5 years	2,184	–	70%	2,165	1,517
2) Good	Less than 2.5 years	146	–	70%	147	103
	Equal to or more than 2.5 years	433	–	90%	488	439
3) Satisfactory	Less than 2.5 years	4	–	115%	1	1
	Equal to or more than 2.5 years	201	–	115%	278	320
4) Weak	Less than 2.5 years	–	–	250%	–	–
	Equal to or more than 2.5 years	9	–	250%	11	26
5) Default	Less than 2.5 years	–	–	0%	–	–
	Equal to or more than 2.5 years	17	–	0%	21	–
Total	Less than 2.5 years	244	–		243	151
	Equal to or more than 2.5 years	2,844	–		2,963	2,302

Pillar 1 Capital requirements: Counterparty credit risk continued

Table 66: Standardised approach – CCR exposures by regulatory portfolio and risk (CCR3)

Exposures are classed as "rated" only where an ECAI rating has been used to derive the risk weight. Where a rating is unavailable, or where the risk weight has been determined by application of specific CRR provisions, exposures have been classed as "unrated".

	2017												
Exposure Classes	**0% £m**	**2% £m**	**4% £m**	**10% £m**	**20% £m**	**50% £m**	**70% £m**	**75% £m**	**100% £m**	**150% £m**	**Others £m**	**Total £m**	**of which: Unrated £m**
Central governments or central banks	**18,319**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**18,319**	**18,319**
Multilateral development banks	**62**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**62**	**62**
International organisations	**65**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**65**	**65**
Institutions	**–**	**8,556**	**–**	**–**	**–**	**9**	**–**	**–**	**8**	**–**	**–**	**8,574**	**8,564**
Corporates	**–**	**–**	**–**	**–**	**225**	**659**	**–**	**–**	**116**	**–**	**–**	**1,000**	**115**
Total – Standardised Approach	**18,447**	**8,556**	**–**	**–**	**225**	**668**	**–**	**–**	**124**	**–**	**–**	**28,020**	**27,126**

	2016												
Exposure Classes	0% £m	2% £m	4% £m	10% £m	20% £m	50% £m	70% £m	75% £m	100% £m	150% £m	Others £m	Total £m	of which: Unrated £m
Central governments or central banks	3,592	–	–	–	–	5	–	–	–	–	–	3,597	3,592
Multilateral development banks	19	–	–	–	–	–	–	–	–	–	–	19	19
International organisations	209	–	–	–	–	–	–	–	–	–	–	209	209
Institutions	–	7,752	–	–	4	5	–	–	–	–	–	7,761	7,752
Corporates	–	–	–	–	139	715	–	–	183	–	–	1,037	180
Total – Standardised Approach	3,820	7,752	–	–	143	725	–	–	183	–	–	12,623	11,752

Key movements

– Central governments or central banks increase of £14.7bn is mainly due to Bank of England repo and Term Funding Scheme increases in the year.

Pillar 1 Capital requirements: Counterparty credit risk continued

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY CONTRACT TYPE

An analysis of counterparty credit risk exposures by contract type, is presented in the table below.

Table 67: CCR: analysis by contract type

	2017 Credit risk exposure £m	2016 Credit risk exposure £m
Interest rate and inflation contracts	14,768	15,725
Foreign exchange contracts	3,167	5,400
Equity contracts	248	182
Credit derivatives	371	336
Commodity contracts	125	163
Securities financing transactions	21,143	8,287
Contributions to the default fund of a Central Counterparty	201	165
Total	**40,023**	30,258
of which: central counterparty	8,556	7,752

NET DERIVATIVES CREDIT EXPOSURE

The gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held and resultant 'net derivatives and SFTs credit exposure', as at 31 December 2017, are presented separately in the table below.

Table 68: Impact of netting and collateral held on exposure values (CCR5-A)

	2017				
	Gross positive fair value exposure amount £m	Netting benefits credit £m	Netted current credit exposure £m	Collateral held £m	Net credit exposure £m
Derivatives	75,403	64,667	10,736	4,459	6,277
SFTs	163,033	–	163,033	147,754	15,279
Total	**238,436**	**64,667**	**173,769**	**152,213**	**21,556**

1 The collateral held values for SFTs are reported after taking into account the volatility adjustments for these balances.

2 The net credit exposure value may differ from the EAD value disclosed in Table 58: Analysis of CCR exposure by approach (CCR1), due to the other parameters for the calculation of the regulatory exposure values not being disclosed in this table.

NOTIONAL VALUE OF CREDIT DERIVATIVE TRANSACTIONS

The notional value of credit derivative transactions outstanding at 31 December 2017 was £19.2bn (2016: £19.0bn). These transactions relate to CDS, total return swaps and other credit derivatives. All total return swaps, including those with gilts underlying, are classified as credit products and are reported in the table below.

Table 69: Credit derivatives exposures (CCR6)

	2017			2016		
	Credit derivative hedges			Credit derivative hedges		
	Protection bought £m	Protection sold £m	Other credit derivatives £m	Protection bought £m	Protection sold £m	Other credit derivatives £m
Notionals						
Single-name credit default swaps	2,288	463	–	1,226	701	–
Index credit default swaps	1,381	146	–	1,734	273	–
Total return swaps	586	8,879	–	637	9,005	–
Credit options	–	–	–	–	–	–
Other credit derivatives	–	5,443	–	–	5,443	–
Total notionals	**4,255**	**14,931**	–	3,598	15,422	–
Fair values						
Positive fair value (asset)	7	70	–	18	290	–
Negative fair value (liability)	(169)	(307)	–	(96)	(547)	–

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.

- Board Risk Appetite for market risk is set at group level covering market risk across all divisions and is reviewed and approved annually.
- Market risk represents a small proportion (1.4%) (2016: 1.5%) of the Group's total risk-weighted assets.
- Risk-weighted assets reduced by 3% to £3.1bn mainly due to a reduction in interest rate exposures.
- Details of market value sensitivity and net interest income sensitivity measures provided in respect of banking activities (non-trading book) can be found in the 2017 Lloyds Banking Group plc Annual Report and Accounts on pages 151 to 156.

Table 70: Market risk own funds requirements

	2017 Risk-weighted assets £m	2017 Capital requirements £m	2016 Risk-weighted assets £m	2016 Capital requirements £m
Internal models approach	**2,656**	**212**	2,795	224
VaR	**141**	**11**	207	17
SVaR	**891**	**71**	1,008	81
Incremental risk charge	**414**	**33**	143	11
Comprehensive risk measure	**–**	**–**	–	–
Risks not in VaR	**1,210**	**97**	1,437	115
Standardised approach	**395**	**32**	352	28
Interest rate risk (general and specific)	**294**	**24**	280	23
Equity risk (general and specific)	**–**	**–**	–	–
Foreign exchange risk	**73**	**6**	55	4
Commodity risk	**–**	**–**	–	–
Specific interest rate risk of securitisation position	**28**	**2**	17	1
Total	**3,051**	**244**	3,147	252

Key movements

Market risk risk-weighted assets reduced by £0.1bn largely due to a decrease in interest rate risk exposure, offset by an increase in the VaR multiplier, an increase in exposure to corporate bonds and refinements to the internal models.

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 prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments), lead to reductions in earnings and/or value. Details of risk appetite, measurement, mitigation and monitoring can be found in the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts (Market risk section, pages 151 to 156).

EXPOSURES

Market risk balance sheet linkages

The information provided in the table below 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 trading book market risk, since it does not discriminate between assets and liabilities in its VaR model.

The table below presents 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 2017 Lloyds Banking Group plc Annual Report and Accounts.

Table 71: Market risk linkages to the balance sheet

		Banking			
31 December 2017	Balance sheet total £m	Trading book only £m	Non-trading £m	Insurance £m	Primary risk factor
Assets					
Cash and balances at central banks	58,521	–	58,521	–	Interest rate
Trading and other financial assets at fair value through profit or loss	162,878	42,230	3,325	117,323	Interest rate, foreign exchange, credit spread
Derivative financial instruments	25,834	21,605	1,881	2,348	Interest rate, foreign exchange, credit spread
Loans and receivables:					
Loans and advances to bank	6,611	–	4,274	2,337	Interest rate
Loans and advances to customers[1]	472,498	–	472,498	–	Interest rate
Debt securities	3,643	–	3,643	–	Interest rate, credit spread
	482,752	–	480,415	2,337	
Available-for-sale financial assets	42,098	–	42,098	–	Interest rate, foreign exchange, credit spread
Value of in-force business	4,839	–	–	4,839	Equity
Other assets	35,187	–	18,303	16,884	Interest rate
Total assets	812,109	63,835	604,543	144,731	
Liabilities					
Deposits from banks	29,804	–	29,804	–	Interest rate
Customer deposits	418,124	–	418,124	–	Interest rate
Trading and other financial liabilities at fair value through profit or loss	50,877	43,062	7,815	–	Interest rate, foreign exchange
Derivative financial instruments	26,124	21,699	1,613	2,812	Interest rate, foreign exchange, credit spread
Debt securities in issue	72,450	–	72,450	–	Interest rate, credit spread
Liabilities arising from insurance and investment contracts	118,860	–	–	118,860	Credit spread
Subordinated liabilities	17,922	–	16,131	1,791	Interest rate, foreign exchange
Other liabilities	28,805	–	8,345	20,460	Interest rate
Total liabilities	762,966	64,761	554,282	143,923	

1 Includes £6.9bn of lower risk loans within the banking book sold by Commercial Banking and Retail to Insurance to manage market risk arising from annuitant liabilities within the insurance business.

Pillar 1 Capital requirements: Market risk continued

The Group's trading book assets and liabilities are originated by Commercial Banking (CB) 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 by the Group 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 CB Markets.

The Group ensures that it has adequate cash and balances at central banks and stocks of high-quality liquid assets (e.g. 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. Further information on these balances can be found under the Risk Management section – Funding and Liquidity risk, pages 144 to 149 of the Lloyds Banking Group plc Annual Report and Accounts.

The majority of debt issuance originates from the issuance, capital vehicles and medium term notes desks and the interest rate risk 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 engage in any proprietary trading activities. The Group's trading activity is undertaken solely to meet the financial requirements of commercial and retail customers for foreign exchange, credit and interest rate products. These activities support customer flow and market making activities.

All trading activities are performed within the Commercial Banking division. While the trading positions taken are generally small, any extreme moves in the main risk factors and other related risk factors could cause significant losses in the trading book depending on the positions at the time.

Trading market risk measures are applied to all the Group's regulatory trading books and they include daily VaR, sensitivity based measures, and stress testing calculations.

Structure and organisation

Market risk follows the Group's Risk Management Framework. For further information refer to "How risk is managed in Lloyds Banking Group" and "Risk Governance" sections on pages 111 to 115 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Banking activities

The Group's banking activities expose it to the risk of adverse movements in market prices, predominantly interest rates, credit spreads, exchange rates and equity prices. 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.

Further details of the Group's risks in the banking book, including market value sensitivity and net interest income sensitivity measures provided in respect of banking activities (non-trading book) are presented in the Market risk section of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Table 72: 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
Banking activities[1]	●	–	–	●	●	–
Defined benefit pension schemes[1]	●	–	–	■	●	–
Insurance portfolios[1]	■	–	–	●	●	–
Trading portfolios[2]	–	–	–	–	–	–

Key:		
Profit before tax:	Loss	Gain
>£500m	●	■
£250m – £500m	●	■
£50m – <£250m	●	■
Immaterial/zero	–	–

1 Banking Activities, Pensions and Insurance stresses; Interest rate -100 bps, Basis Risk 3 month London Interbank Offered Rate (LIBOR) +100bps / Bank Base Rate -25bps, Foreign Exchange (FX) -15 per cent GBP, Credit Spread +100 per cent, Equity -30 per cent, Inflation +50 bps

2 Trading Portfolios; Interest rate +30bps, FX +5 per cent GBP, Credit spread +20 per cent, Inflation +50bps.

For further information on the key market risks by defined benefit pension schemes and Insurance portfolios refer to pages 154 and 155 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Market risk continued

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. The VaR model allows diversification across the different risk factors. The Pillar 1 market risk capital requirements also include an Incremental Risk Charge (IRC) for the trading book.

The Group uses a 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, either proportional or absolute shifts depending on the risk factor. 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 for both management purposes and regulatory purposes. A 1-day 95th percentile VaR is used for internal management purposes, and a 10-day 99th percentile VaR and Stressed VaR is applied for regulatory capital calculation purposes. The 10-day VaR uses a rolling 10 day history and this is updated daily. 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 IRC model simulates the impact of ratings transitions by estimating the improvement or deterioration in credit spreads resulting from these transitions. The ratings transition matrices are comprised of historical transitions collated over many decades and are updated annually for both corporates and sovereigns. 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. Correlations between obligors are based on an existing LBG factor model, which consists of industry sectors and geographical regions. The model also allows for idiosyncratic behaviour at obligor level. The asset returns for obligors are computed using a multi-factor Gaussian Copula model framework for which the factor model provides the correlation basis.

LBG ensures that the IRC model is consistent with the soundness standard comparable to that of the internal-ratings based approach for credit risk. The Lloyds IRC model employs a confidence interval of 99.9% and both its liquidity and risk horizons are set to be one year. This is fully consistent with the EBA soundness standard for IRC models. The annual validation of the IRC model ensures that the soundness standard comparable to IRB is maintained.

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). Identification of risks is performed at least quarterly and through the new product review process to ensure any additional risks outside of VaR and IRC models are captured as RNIV's. Where risk factors are incorporated into the RNIV framework they are quantified either through a VaR-based RNIV approach or a stress test approach. RNIVs can arise for a number of reasons such as where there is limited historical market data, event risks not captured in the current historical data or limited variability in the market data or risks not captured elsewhere such as cross risks, basis risks and higher-order risks.

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 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: (£11m)	Historical simulation to create a distribution of potential daily P&Ls from market moves. P&Ls are calculated from a grid of full revaluation based sensitivities to approximate/ estimate full revaluation.	300 daily P&Ls, Simple weighting.	Regulatory VaR is computed with 10 day holding period and 99% confidence level. The 10-day VaR is based on rolling 10-day periods.
SVaR	1Model: (£71m)	Same as VaR model.	250 day period of significant stress. Simple weighting. VaR calibration updated quarterly.	Same as VaR model.
IRC	1Model: (£33m)	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.

Pillar 1 Capital requirements: Market risk continued

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 CB 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 monthly and new stress tests are introduced when deemed necessary.

Backtesting of VaR models

The Group compares both hypothetical and clean profit or loss with the 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 due to market moves that would have resulted assuming that the portfolio remains unchanged. Clean profit or loss is hypothetical profit or loss with the additional profit or loss from the change in the portfolio's value due to time. Fees and commissions do not feed into either profit and loss measure.

A backtesting overshoot is generated when loss is greater than the 1-day 99 per cent VaR for a given day. Please see commentary below Table 73 for information on backtesting performance.

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 Approach 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.

Table 73: Backtesting results (VaR models)

2017 backtesting results		Number of reported overshoots	
	Multiplier[1]	Hypothetical	Clean
Entity Level			
Lloyds Bank	**3.00**	**4**	**1**
HBOS	**3.00**	**–**	**–**
LBG	**3.40**	**5**	**3**

1 The increase in the number of backtesting overshoots outstanding over the last 250 business days has resulted in the VaR multiplier used for internal model capital requirements increasing for LBG to 3.4 from 3.0 at 31 December 2017.

Key movements

– Statistically the Group would expect to see losses in excess of VaR two to three times over a one-year period. Details of LBG loss overshoots are provided in the backtesting chart comparing VaR to hypothetical and clean profit and loss (Table 74).

– The number of overshoots has increased in 2017 with three overshoots occurring in December 2017 partly due to significant moves in cross currency spreads over the 2017 year end period.

– The Group continues to review and improve its VaR model to better capture all relevant risks in its trading portfolio. All significant profit and loss events are investigated as part of normal business. In addition, all backtesting overshoots are reported to senior management, internal auditors and the PRA.

Pillar 1 Capital requirements: Market risk continued

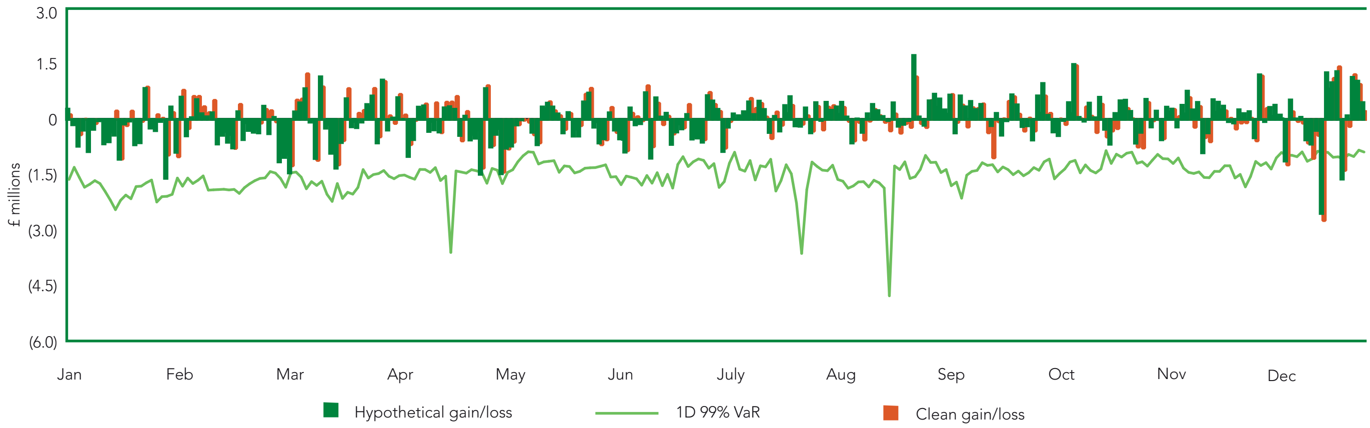
COMPARISON OF VAR TO HYPOTHETICAL AND CLEAN PROFIT AND LOSS

The following chart provides a comparison of VaR (1-day 99 per cent confidence level) to the hypothetical and clean profit and loss on a daily basis over the course of 2017.

Note that the profit and loss used in back-testing represents gains and losses based on the change in valuation of the portfolio due to market moves and is not reflective of the total profit and loss from CB Markets.

Table 74: Comparison of VaR estimates with gains/losses (MR4)

LLOYDS BANKING GROUP



Information behind the backtesting overshoots at LBG level is listed below.

Backtesting Overshoot Date	Hypothetical / Clean Exception	Key driver(s)
03-Mar-17	Hypothetical only	Driven by movements in both interest rates and exchange rates.
27-Apr-17	Hypothetical only	Driven by movements in both interest rates and exchange rates.
06-Dec-17	Hypothetical and Clean	Driven by movements in both interest rates and exchange rates.
15-Dec-17	Hypothetical and Clean	Driven by significant movements in short term GBPUSD cross currency basis swap spreads.
21-Dec-17	Hypothetical and Clean	Driven by significant movements in short term GBPUSD cross currency basis swap spreads.

Valuation principles

Trading securities, other financial assets and liabilities at fair value through profit or loss, derivatives and AFS financial assets are stated at fair value. The fair value of these financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is a measure at a specific date and may be significantly different from the amount which will actually be paid or received on maturity or settlement date.

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

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

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

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

Full details on the use of valuation models and related adjustments are provided in Note 48 (Financial instruments) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Pillar 1 Capital requirements: Market risk continued

Trading portfolios

The Group internally uses VaR as the primary risk measure for all trading book positions.

The table below provides relevant statistics for the Group's 10-day 99 per cent confidence level VaR that are based on 300 historical consecutive business days to year end 2017 and year end 2016. Also included are statistics for the Incremental Risk Change for 2017 and 2016.

The risk of loss measured by the VaR model is the minimum expected loss in earnings given a 99 per cent confidence. The total and average trading VaR numbers reported below have been obtained after the application of the diversification benefits across the different risk types: interest rate, foreign exchange, credit spread and inflation risk.

Table 75: IMA values for trading portfolios (MR3)

	2017 £m	2016 £m
VaR (10 day 99%)		
Maximum value	**9.7**	42.7
Average value	**3.6**	10.3
Minimum value	**1.7**	2.7
Period end	**2.6**	4.1
Stressed VaR (10 day 99%)		
Maximum value	**54.0**	38.3
Average value	**25.2**	19.5
Minimum value	**9.3**	8.7
Period end	**9.3**	13.4
Incremental Risk Charge (99.9%)		
Maximum value	**79.2**	30.5
Average value	**21.4**	13.5
Minimum value	**7.6**	6.1
Period end	**18.7**	8.3
Comprehensive Risk capital charge (99.9%)		
Maximum value	**–**	–
Average value	**–**	–
Minimum value	**–**	–
Period end	**–**	–

Key movements

- The reduction in average VaR (10 day 99%) is as a result of the very high VaR figures during the first half of 2016. As reported in the 2016 Pillar 3 report, this was as a result of the impact of low to negative EUR interest rates which resulted in an overstatement in the VaR. Model refinements to more accurately reflect the risk and align the model with SVaR methodology were implemented in June 2016 which reduced the VaR significantly over the second half of 2016 and in 2017. Reduced market volatility also helped reduce the VaR (10 day 99%) in 2017 compared to 2016.
- The increase in average Stressed VaR (SVaR) was due to an increase in exposures to interest rates and credit spreads. SVaR decreased in the final months of 2017 and hence the SVaR at period end was lower in 2017 than at year end 2016.
- The increase in IRC was due to an increase in positions in corporate bonds over the year from comparatively low levels in 2016.

Pillar 1 Capital requirements: Market risk continued

Table 76: Market risk under internal models approach (MR2-A)

		2017 RWA £m	2017 Capital requirements £m	2016 RWA £m	2016 Capital requirements £m
1	**VaR** (higher of values a and b)	**141**	**11**	207	17
(a)	Previous day's VaR (Article 365(1) (VaRt-1))		**3**		4
(b)	Average of the daily VaR (Article 365(1)) on each of the preceding sixty business days (VaRavg) x multiplication factor ((mc) in accordance with Article 366)		**11**		17
2	**SVaR** (higher of values a and b)	**891**	**71**	1,008	81
(a)	Latest SVaR (Article 365(2) (sVaRt-1))		**9**		13
(b)	Average of the SVaR (Article 365(2) during the preceding sixty business days (sVaRavg) x multiplication factor (ms) (Article 366)		**71**		81
3	Incremental risk charge – **IRC** (higher of values a and b)	**414**	**33**	143	11
(a)	Most recent IRC value (incremental default and migration risks section 3 calculated in accordance with Section 3 articles 370/371)		**19**		8
(b)	Average of the IRC number over the preceding 12 weeks		**33**		11
4	Comprehensive Risk Measure – **CRM** (higher of values a, b and c)	**–**	**–**	–	–
(a)	Most recent risk number for the correlation trading portfolio (article 377)		**–**		–
(b)	Average of the risk number for the correlation trading portfolio over the preceding 12-weeks		**–**		–
(c)	8% of the own funds requirement in SA on most recent risk number for the correlation trading portfolio (Article 338(4))		**–**		–
5	**RNIV**	**1,210**	**97**	1,437	115
6	**Total**	**2,656**	**212**	2,795	224

Table 77: Risk-weighted assets flow statements of market risk exposures under an IMA (MR2-B)

	VaR £m	SVaR £m	IRC £m	CRM £m	RNIV £m	Total RWA[1] £m	Total capital requirements £m
Risk-weighted assets as at 31 December 2016	**207**	**1,008**	**143**	**–**	**1,437**	**2,795**	**224**
Movement in risk levels	**(83)**	**(189)**	**153**	**–**	**(370)**	**(489)**	**(39)**
Model updates/changes	**17**	**72**	**118**	**–**	**143**	**350**	**28**
Methodology and policy	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Acquisitions and disposals	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Other	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Risk-weighted assets at 31 December 2017	**141**	**891**	**414**	**–**	**1,210**	**2,656**	**212**

1 The table above relates solely to movement in exposures under an IMA approach. Total Market risk risk-weighted assets are disclosed by key driver in Table 7. Note that the asset size driver disclosed therein is encompassed in movement in risk levels above.

Key movements

– Internal models approach risk-weighted assets decreased due to a reduction in interest rate exposure for VaR, SVaR and Risks not in VaR or SVaR. This was partly offset by an increase in IRC from increased exposure to corporate bonds, an improvement to the IRC model and an increase in the VaR multiplier as a result of the backtesting overshoots.

– As part of model refinements a number of risks captured as RNIVs were moved into the VaR model in 2016 and 2017 and a material proportion of the remaining RNIVs will be moved into the VaR model during 2018.

Pillar 1 Capital requirements: Market risk continued

Table 78: Market risk under Standardised approach (MR1)

	2017 Risk-weighted assets £m	2017 Capital requirements £m	2016 Risk-weighted assets £m	2016 Capital requirements £m
Outright Products				
Interest rate risk (general and specific)	**294**	**24**	280	23
Equity risk (general and specific)	**–**	**–**	–	–
Foreign exchange risk	**73**	**6**	55	4
Commodity Risk	**–**	**–**	–	–
Securitisation (specific risk)	**28**	**2**	17	1
Options				
Simplified approach	**–**	**–**	–	–
Delta-plus method	**–**	**–**	–	–
Scenario approach	**–**	**–**	–	–
Total	**395**	**32**	352	28

Key movements

– Market risk under the Standardised approach remained low over 2017.

Pillar 1 Capital requirements: Operational risk

Lloyds Banking Group's operational risk capital requirements are determined under the Standardised Approach.

- Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, which can lead to adverse customer impact, reputational damage or financial loss.
- Operational risk is managed across the Group through an operational risk framework and operational risk policies. Details of the Group's Operational Risk profile and Risk Management Framework can be found in the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts (pages 135 and 136).
- The Group's strategic review considers the changing risk management requirements, adapting the change delivery model to be more agile and develop the required people skills and capabilities. The Group continues to review and invest in its control environment to ensure it addresses the inherent risks faced.
- Monitoring and reporting of operational risk is undertaken at Board, Group and divisional risk committees.
- The Group calculates its operational risk capital requirements using the Standardised Approach. As at 31 December 2017, the Pillar 1 capital requirement in respect of operational risk amounted to £2,026m (2016: £2,023m).

Liquidity Risk

This section details Lloyds Banking Group's liquidity risk profile, focusing in particular on the Group's weighted average Liquidity Coverage Ratio.

- In March 2017, the EBA published final guidelines to harmonise and specify the public disclosure requirements laid down as part of the CRR in relation to information on liquidity risk management and the Liquidity Coverage Ratio (LCR). In the same month, the Basel Committee on Banking Supervision published final technical standards on Liquidity.
- To fully address new requirements, additional quantitative and qualitative information has been included in this section of the Pillar 3 document, and in the Risk Management section of the 2017 Lloyds Banking Group Annual Report and Accounts (pages 144 to 149).
- Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due. Liquidity exposure represents the potential stressed outflows in any future period less expected inflows.
- Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturities with behavioural overlays as appropriate. Additionally the Group undertakes quantitative and qualitative analysis of behavioural aspects of its assets and liabilities in order to reflect their expected behaviour.
- Group Corporate Treasury is responsible for managing and monitoring liquidity risks on behalf of the Group and ensuring that liquidity risk management systems and arrangements are adequate with regard to the internal risk appetite and Group strategy.
- Daily monitoring and control processes are in place to address internal and regulatory requirements. In addition, the Group carries out internal stress testing of its liquidity and maintains a Contingency Funding Plan, which is designed to identify emerging liquidity concerns at an early stage.
- The Group's liquidity surplus continues to exceed the regulatory minimum and internal risk appetite, with a weighted average Liquidity Coverage Ratio of 125 per cent at 31 December 2017.

Liquidity Risk continued

LIQUIDITY COVERAGE RATIO (LCR)

The scope of the LCR disclosure is the Domestic Liquidity Sub-Group (DoLSub) which is the primary regulatory liquidity banking group approved by the PRA. The banks in the DoLSub have in place a multi-currency committed loan facility agreement to ensure that liquidity can flow completely freely throughout the DoLSub.

The LCR is calculated on significant currency and a consolidated-all currencies basis which are all subject to internal risk appetite. The Group holds additional LCR eligible liquid assets to cover a PRA defined Pillar II buffer capturing liquidity risk not included in the LCR. The LCR is monitored on a daily basis and forms part of a group of early warning indicators.

The Group's funding and liquidity position is underpinned by its significant customer deposit base, and is supported by strong relationships across customer segments. The composition of the Group's funding results in a low LCR outflow requirement relative to the overall size of the funding base, as a large proportion of this deposit base comes from Retail customers, which in aggregate provide a stable source of funding. The LCR captures both contractual derivative outflows and the impact of an adverse market scenario on derivative outflows and collateral calls. In addition, derivative outflows are subject to internal risk appetite through the Group's stress testing.

Further details on the Group's liquidity portfolio can be found in the Risk Management section of the 2017 Lloyds Banking Group plc Annual Report and Accounts (Funding and Liquidity section, pages 144 to 149).

The table below presents the breakdown of the Group's cash outflows and cash inflows, as well as its available high quality liquid assets, calculated as the simple averages of month end observations over the 12 months preceding the end of each quarter.

Table 79: Liquidity Coverage Ratio (LIQ1)

	2017							
	Total unweighted value (average) £m				Total weighted value (average) £m			
	At 31 Mar	At 30 Jun	At 30 Sep	At 31 Dec	At 31 Mar	At 30 Jun	At 30 Sep	At 31 Dec
High-quality liquid assets								
Total HQLA					133,568	132,437	126,789	124,543
Cash outflows								
Retail deposits and deposits from small business customers, of which:	271,852	273,392	275,227	274,801	18,284	18,276	18,295	18,123
Stable deposits	210,309	211,896	214,278	216,076	10,515	10,595	10,714	10,804
Less stable deposits	61,542	61,496	60,948	58,725	7,769	7,681	7,581	7,319
Unsecured wholesale funding:	105,569	101,536	96,396	96,106	63,794	60,140	55,456	54,243
Operational deposits (all counterparties) and deposits in networks of cooperative banks	18,065	19,292	20,887	22,348	4,516	4,823	5,222	5,587
Non-operational deposits (all counterparties)	85,174	79,830	73,167	71,666	56,948	52,902	47,892	46,564
Unsecured debt	2,330	2,415	2,342	2,092	2,330	2,415	2,342	2,092
Secured wholesale funding					220	190	135	87
Additional requirements:	118,696	108,210	97,018	84,470	35,994	35,180	34,336	32,590
Outflows related to derivative exposures and other collateral requirements	20,499	20,489	20,523	19,710	20,482	20,476	20,507	19,696
Outflows related to loss of funding on debt products	2,014	1,882	1,766	1,544	2,014	1,882	1,766	1,544
Credit and liquidity facilities	96,183	85,839	74,729	63,216	13,497	12,823	12,063	11,350
Other contractual funding obligations	759	1,460	1,679	2,409	–	704	923	1,653
Other contingent funding obligations	24,628	35,278	45,627	55,463	2,952	3,152	3,340	3,465
TOTAL CASH OUTFLOWS					121,244	117,642	112,485	110,160
Cash inflows								
Secured lending (eg: reverse repos)	9,548	12,442	15,005	18,783	171	205	288	419
Inflows from fully performing exposures	7,675	7,763	7,911	7,855	5,742	5,731	5,861	5,897
Other cash inflows	4,389	3,716	3,686	4,308	4,225	3,550	3,519	4,141
(Difference between total weighted inflows and total weighted outflows arising from transactions in third countries where there are transfer restrictions or which are denominated in non-convertible currencies)					–	–	–	–
(Excess inflows from a related specialised credit institution)					–	–	–	–
TOTAL CASH INFLOWS	21,612	23,920	26,603	30,945	10,139	9,486	9,668	10,457
Fully exempt flows	–	–	–	–	–	–	–	–
Inflows subject to 90% cap	–	–	–	–	–	–	–	–
Inflows subject to 75% cap	21,190	21,896	22,905	24,974	10,139	9,486	9,668	10,457
								Total adjusted value £m
Liquidity buffer					133,568	132,437	126,789	124,543
Total net cash outflows					111,106	108,156	102,817	99,703
Liquidity Coverage Ratio (%)					120%	123%	123%	125%

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer

OWN FUNDS DISCLOSURE TEMPLATE

Table 80: Own funds template

	Transitional rules		Fully loaded rules	
	At 31 Dec 2017 £m	At 31 Dec 2016 £m	**At 31 Dec 2017 £m**	At 31 Dec 2016 £m
Common equity tier 1 (CET1) capital: instruments and reserves				
Capital instruments and related share premium accounts	**24,831**	24,768	**24,831**	24,768
of which: called up share capital	**7,197**	7,146	**7,197**	7,146
of which: share premium	**17,634**	17,622	**17,634**	17,622
Retained earnings	**8,301**	7,716	**8,301**	7,716
Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	**11,598**	11,718	**11,598**	11,718
Foreseeable dividend	**(1,475)**	(1,568)	**(1,475)**	(1,568)
Common equity tier 1 (CET1) capital before regulatory adjustments	**43,255**	42,634	**43,255**	42,634
Common equity tier 1 (CET1) capital: regulatory adjustments				
Additional value adjustments	**(556)**	(630)	**(556)**	(630)
Intangible assets (net of related tax liability)	**(2,966)**	(1,623)	**(2,966)**	(1,623)
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)	**(3,255)**	(3,564)	**(3,255)**	(3,564)
Fair value reserves related to gains or losses on cash flow hedges	**(1,405)**	(2,136)	**(1,405)**	(2,136)
Negative amounts resulting from the calculation of expected loss amounts	**(498)**	(602)	**(498)**	(602)
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	**83**	(2)	**83**	(2)
Defined benefit pension fund assets	**(541)**	(267)	**(541)**	(267)
Direct and indirect holdings by the Group of own CET1 instruments	**(29)**	(27)	**(29)**	(27)
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)	**(4,250)**	(4,282)	**(4,250)**	(4,282)
Exposure amount of the following items which qualify for a risk weight of 1,250%, where the Group has opted for the deduction alternative	**(191)**	(217)	**(191)**	(217)
of which: securitisation positions	**(191)**	(217)	**(191)**	(217)
Amount exceeding the 15% threshold	**–**	–	**–**	–
of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	**–**	–	**–**	–
of which: deferred tax assets arising from temporary differences	**–**	–	**–**	–
Total regulatory adjustments applied to common equity tier 1 (CET1)	**(13,608)**	(13,350)	**(13,608)**	(13,350)
Common equity tier 1 (CET1) capital	**29,647**	29,284	**29,647**	29,284
Additional tier 1 (AT1) capital: instruments				
Capital instruments and related share premium accounts	**5,330**	5,320	**5,330**	5,320
of which: classified as equity under applicable accounting standards	**5,330**	5,320	**5,330**	5,320
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	**501**	592	**–**	–
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	**2,254**	2,714	**–**	–
of which: instruments issued by subsidiaries subject to phase out	**2,254**	2,714	**–**	–
Additional tier 1 (AT1) capital before regulatory adjustments	**8,085**	8,626	**5,330**	5,320
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	**(1,403)**	(1,329)	**–**	–
of which: significant investments in Tier 2 instruments of other financial sector entities	**(1,403)**	(1,329)	**–**	–
Total regulatory adjustments applied to additional tier 1 (AT1) capital	**(1,403)**	(1,329)	**–**	–
Additional tier 1 (AT1) capital	**6,682**	7,297	**5,330**	5,320
Tier 1 capital	**36,329**	36,581	**34,977**	34,604

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

	Transitional rules		Fully loaded rules	
	At 31 Dec 2017 £m	At 31 Dec 2016 £m	**At 31 Dec 2017 £m**	At 31 Dec 2016 £m
Tier 2 (T2) capital: Instruments and provisions				
Capital instruments and related share premium accounts	**3,531**	3,813	**4,032**	4,404
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 interests and AT1 instruments not included in CET1 or AT1) issued by subsidiaries and held by third parties	**6,185**	7,104	**2,784**	3,328
of which: instruments issued by subsidiaries subject to phase out	**3,352**	3,711	**–**	–
Credit risk adjustments	**120**	186	**120**	186
Tier 2 (T2) capital before regulatory adjustments	**9,846**	11,113	**6,936**	7,918
Tier (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)	**(1,516)**	(1,571)	**(2,919)**	(2,900)
Total regulatory adjustments applied to tier 2 (T2) capital	**(1,516)**	(1,571)	**(2,919)**	(2,900)
Tier 2 (T2) capital	**8,330**	9,542	**4,017**	5,018
Total capital	**44,659**	46,123	**38,994**	39,622
Total risk-weighted assets	**210,919**	215,534	**210,919**	215,534
Capital ratios and buffers				
Common Equity Tier 1 (as a percentage of risk exposure amount)	**14.1%**	13.6%	**14.1%**	13.6%
Tier 1 (as a percentage of risk exposure amount)	**17.2%**	17.0%	**16.6%**	16.1%
Total capital (as a percentage of risk exposure amount)	**21.2%**	21.4%	**18.5%**	18.4%
Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	**1.252%**	0.627%	**1.252%**	0.627%
of which: capital conservation buffer requirement[1]	**1.250%**	0.625%	**1.250%**	0.625%
of which: countercyclical buffer requirement	**0.002%**	0.002%	**0.002%**	0.002%
Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)[2]	**9.6%**	9.1%	**9.6%**	9.1%
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)	**921**	1,040	**921**	1,040
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)	**3,390**	3,357	**3,390**	3,357
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in 38 (3) are met)	**678**	984	**678**	984
Applicable caps on the inclusion of provisions in Tier 2				
Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	**120**	186	**120**	186
Cap on inclusion of credit risk adjustments in T2 under internal ratings-based approach	**866**	932	**866**	932
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	**2,755**	3,305	**–**	–
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	**1,617**	1,419	**–**	–
Current cap on T2 instruments subject to phase out arrangements	**7,167**	8,600	**–**	–

1 The capital conservation buffer requirement is the percentage applicable at the reporting date. This will increase to 2.5 per cent by 2019.

2 Excluding CET1 required to meet Pillar 2A requirements.

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

OWN FUNDS RECONCILIATION

The following table presents certain items from the Group's consolidated regulatory balance sheet (as presented on pages 8 and 9), for the year ended 31 December 2017, 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 81: Items extracted from the consolidated regulatory balance sheet and reconciliation of own funds items to audited financial statements

Lloyds Banking Group balance sheet category	Own funds description	Items extracted from the consolidated regulatory balance sheet (1) £m	Adjustments: Deferred tax £m	Adjustments: Threshold adjustments £m	Adjustments: Amounts excluded from AT1 due to Cap (13) £m	Adjustments: Regulatory and other adjustments £m	Transitional own funds £m	Notes
	Common Equity Tier 1 (CET1) capital: instruments and reserves							
	Capital instruments and related share premium accounts	24,831	–	–	–	–	24,831	
Share capital	of which: called up share capital	7,197	–	–	–	–	7,197	
Share premium	of which: share premium	17,634	–	–	–	–	17,634	
Retained profits	Retained earnings	8,262	–	–	–	39	8,301	2
Other reserves	Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	11,756	–	–	–	(158)	11,598	2
	Common equity tier 1 (CET1) capital: regulatory adjustments							
	Additional value adjustments	–	–	–	–	(556)	(556)	3
Goodwill and other intangible assets	Intangible assets (net of related tax liability)	(3,154)	188	–	–	–	(2,966)	4
Deferred tax assets	Deferred tax assets that rely on future profitability, excluding those arising from temporary differences (net of related tax liability where conditions in Article 38(3) of the CRR are met)	(3,110)	(826)	678	–	3	(3,255)	5
	Fair value reserves related to gains or losses on cash flow hedges	–	–	–	–	(1,405)	(1,405)	6
	Negative amounts resulting from the calculation of expected loss amounts	–	–	–	–	(498)	(498)	7
	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	–	–	–	–	83	83	8
Retirement benefit assets	Defined benefit pension fund assets	(723)	182	–		–	(541)	5
	Direct and indirect holding by the Group of own CET1 instruments	–	–	–	–	(29)	(29)	9
Investment in group undertakings	Direct and indirect holdings by the Group of CET1 instruments in financial sector entities where the Group has a significant investment in those entities (amounts above 10% threshold and net of eligible short positions)	(8,004)	–	3,390	–	364	(4,250)	10
	Exposures amount of the following items which qualify for a risk weight of 1,250%, where the Group has opted for the deduction alternative (securitisation positions)	–	–	–	–	(191)	(191)	11
	Foreseeable dividend	–	–	–	–	(1,475)	(1,475)	12
	Common Equity Tier 1 (CET1) capital	**29,858**	**(456)**	**4,068**	**–**	**(3,823)**	**29,647**	
	Additional Tier 1 (AT1) capital: instruments							
Other equity instruments	Capital instruments and the related share premium accounts	5,355	–	–	–	(25)	5,330	
Subordinated 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	813	–	–	(294)	(18)	501	13
Subordinated liabilities	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	3,721	–	–	(1,324)	(143)	2,254	13
	Additional Tier 1 (AT1) capital: regulatory adjustments							
Trading and other financial assets at fair value through profit or loss	Residual amounts deducted from AT1 capital with regard to deduction from T2 capital during the transitional period pursuant to article 475 of the CRR (significant investments)	(2,036)	–	–	–	633	(1,403)	14
	Additional Tier 1 (AT1) capital	**7,853**	**–**	**–**	**(1,618)**	**447**	**6,682**	
	Tier 1 capital	**37,711**	**(456)**	**4,068**	**(1,618)**	**(3,376)**	**36,329**	
	Tier 2 (T2) capital: instruments and provisions							
Subordinated liabilities	Capital instruments and related share premium accounts	3,263	–	–	294	(26)	3,531	13
Subordinated liabilities	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	13
Subordinated liabilities	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	8,422	–	–	1,324	(3,561)	6,185	13
	Credit risk adjustments	–	–	–	–	120	120	15
	Tier 2 (T2) capital: regulatory adjustments							
Loans and receivables	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)	(578)	–	–	–	–	(578)	
Trading and other financial assets at fair value through profit or loss	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)	–	–	–	–	(938)	(938)	14
	Tier 2 (T2) capital	**11,117**	**–**	**–**	**1,618**	**(4,405)**	**8,330**	
	Total capital	**48,828**	**(456)**	**4,068**	**–**	**(7,781)**	**44,659**	

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

1 Assets on the regulatory balance sheet are presented as negative amounts, liabilities and equity are presented as positive amounts.

2. 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.

3. The additional value adjustments of £556m reflect the prudent valuation adjustment for all assets measured at fair value in accordance with Articles 34 and 105 of the CRR. Table 82 on page 115 provides a breakdown of the constituent elements of the Group's prudent valuation adjustment.

4. Own funds intangible assets of £3,154m extracted from the consolidated regulatory balance sheet comprise £488m of goodwill and £2,666m of intangible assets. CRD IV rules require the amount to be deducted from own funds to be reduced by the amount of the associated deferred tax liabilities.

5. The own funds deduction of £3,255m for deferred tax excludes the deferred tax balances relating to intangible assets, cash flow hedge 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 CRR are met. £678m of the deferred tax assets relate to temporary differences that may be risk weighted instead of deducted from capital as presented in the threshold adjustments column.

6. Cash flow hedge reserve forms part of other reserves in the consolidated regulatory balance sheet. Please refer to note 41 Other Reserves in the 2017 Lloyds Banking Group plc Annual Report and Accounts.

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 of £498m 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 page 77.

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. The £29m deduction of 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 Companies (OEICs) as these shareholdings are held for third party investors through the Group's Insurance operations.

10. The investment in group undertakings of £8,004m 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 Limited. The own funds deduction of £4,250m 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 capital (as presented in the threshold adjustments column), with the remainder deducted from CET1.

11. The £191m deduction for securitisation positions reflects those positions that were rated below BB- or that are unrated.

12. The £1,475m foreseeable dividend is that recommended by the Board of Directors in respect of 2017 earnings.

13. A reconciliation of subordinated liabilities from the consolidated regulatory balance sheet to the amount recognised against each own funds description is presented in the table below.

Own funds description	Consolidated regulatory balance sheet total £m
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	813
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in CET1) issued by subsidiaries and held by third parties	3,721
Capital instruments and related share premium accounts	3,263
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	8,422
Total subordinated liabilities as presented on the consolidated regulatory balance sheet, page 9	16,229

Adjustments required by regulatory rules to the value of subordinated liabilities presented within the regulatory and other adjustments column on the reconciliation include adjustments for accrued interest, amortisation and associated derivatives.

Additional Tier 1 instruments presented in own funds reflect instruments issued by either Lloyds Banking Group plc or its subsidiaries and held by third parties that qualified as Tier 1under regulation that preceded CRD IV, subject to certain restrictions, including a cap set at 50 per cent 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 instruments which have been issued in the same manner as Additional Tier 1 instruments and are net of interest and in some instances amortisation and associated derivatives.

14. The £2,036m 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 2017, 20% of the total investment is deducted equally from AT1 and T2, with the remainder deducted directly from AT1 or T2 in line with the classification of the underlying debt instrument.

15. Credit risk adjustments of £120m 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 page 77.

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

PRUDENT VALUATION ADJUSTMENTS

The table below provides a breakdown of the constituent elements of the Group's Prudent Valuation Adjustments (PVA).

Table 82: Prudent valuation adjustments (PV1)

	2017							
	Equity £m	Interest rates £m	FX £m	Credit £m	Commodities £m	Total £m	of which: In the trading book £m	of which: In the banking book £m
Closeout uncertainty, of which:	233	285	20	66	1	604	263	341
Mid-market value	202	148	19	20	1	390	120	271
Closeout cost	4	109	1	6	–	120	108	12
Concentration	27	28	–	40	–	94	36	58
Early termination	–	–	–	–	–	–	–	–
Model risk	–	30	5	–	–	36	35	1
Operational risk	21	26	2	3	–	51	23	28
Investing and funding costs						58	–	58
Unearned credit spreads						66	–	66
Future administrative costs	–	9	–	5	–	14	9	5
Other[1]	(103)	(144)	(13)	(13)	–	(273)	(131)	(142)
Total adjustment						556		

1 'Other' adjustments capture the diversification benefit which is permitted under EBA Regulatory Technical Standards on Prudent Valuation.

Types of financial instruments on which the highest PVA is observed include unlisted equity positions, inflation swaps, cross currency swaps and uncollateralised derivatives with associated funding and credit valuation adjustments.

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

LEVERAGE DISCLOSURE TEMPLATE (CRD IV)

Table 83: Leverage ratio common disclosure

	At 31 Dec 2017 Fully loaded £m	At 31 Dec 2016 Fully loaded £m
On-balance sheet exposures (excluding derivatives and SFTs)		
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**596,695**	596,415
Asset amounts deducted in determining Tier 1 capital	**(7,658)**	(9,128)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**589,037**	587,287
Derivative exposures		
Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	**5,699**	7,863
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**12,335**	13,188
Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	**1,716**	1,636
Deductions of receivables assets for cash variation margin provided in derivatives transactions	**(4,035)**	(4,686)
Adjusted effective notional amount of written credit derivatives	**997**	1,088
Adjusted effective notional offsets and add-on deductions for written credit derivatives	**(116)**	(389)
Total derivative exposures	**16,596**	18,700
Securities financing transaction exposures		
Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**56,401**	44,617
Netted amounts of cash payables and cash receivables of gross SFT assets	**(11,911)**	(3,858)
Counterparty credit risk exposure for SFT assets	**2,596**	1,677
Total securities financing transaction exposures	**47,086**	42,436
Other off-balance sheet exposures		
Off-balance sheet exposures at gross notional amount	**147,814**	129,214
Adjustments for conversion to credit equivalent amounts	**(89,457)**	(70,529)
Other off-balance sheet exposures	**58,357**	58,685
Capital and total exposure measure		
Tier 1 capital	**34,977**	34,604
Total leverage ratio exposures	**711,076**	707,108
Leverage ratio		
Leverage ratio	**4.9%**	4.9%

A description of the factors that had an impact on the leverage ratio during the year is discussed on page 24.

Table 84: Summary reconciliation of accounting assets and leverage ratio exposures

	At 31 Dec 2017 Fully loaded £m	At 31 Dec 2016 Fully loaded £m
Total assets as per published financial statements	**812,109**	817,793
Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(142,515)**	(145,246)
Adjustments for derivative financial instruments	**(7,195)**	(15,035)
Adjustments for securities financing transactions (SFTs)	**(2,022)**	39
Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	**58,357**	58,685
Other adjustments	**(7,658)**	(9,128)
Total leverage ratio exposure	**711,076**	707,108

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

Table 85: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

	At 31 Dec 2017 Fully loaded £m	At 31 Dec 2016 Fully loaded £m
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**596,695**	596,415
Trading book exposures	**10,647**	12,174
Banking book exposures, of which:	**586,048**	584,241
Covered bonds	**727**	2,363
Exposures treated as sovereigns	**96,589**	98,799
Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**6**	2
Institutions	**2,716**	2,252
Secured by mortgages of immovable properties	**323,415**	325,290
Retail exposures	**42,575**	32,176
Corporates	**74,016**	77,679
Exposures in default	**7,651**	8,775
Other exposures (eg equity, securitisations, and other non-credit obligation assets)	**38,353**	36,905

Description of the processes used to manage the risk of excessive leverage
Capital is actively managed and regulatory ratios, including leverage, are a key factor in the Group's internal risk appetite assessment, planning processes and stress analyses.

Capital plans include an assessment of leverage requirements over the forecast period, with capital adequacy in respect of both risk-based capital and leverage requirements subjected to a range of stress scenarios. Where relevant the scenarios consider the risk of excessive leverage and potential mitigating actions that could be undertaken in response.

The Group monitors its leverage position through a combination of actual and projected ratios, including those under stressed scenarios, ensuring that the ratio exceeds regulatory minimums and internal risk appetite and reports these on a regular basis to the Group Asset and Liability Committee, the Group Executive Committee, the Group Risk Committee, Board Risk Committee and the Board.

Further details on the process by which the Group manages its capital position in respect of both risk-based capital and leverage requirements is discussed in the Capital Risk section on pages 137 to 144 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Appendix 1: Own Funds, Prudent Valuation Adjustments, Leverage and Countercyclical Capital Buffer continued

Table 86: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

	2017 General credit exposures[2,3]		2017 Trading book exposures[2,4]		2017 Securitisation exposures[3]		2017 Own funds requirements					
Breakdown by Country	**Exposure Value for SA**	**Exposure Value for IRB**	**Sum of long and short positions of trading book exposures for SA**	**Value of trading book exposures for internal models**	**Exposure Value for SA**	**Exposure Value for IRB**	**of which: General credit exposures[2,3]**	**of which: Trading book exposures[2,4]**	**of which: Securitisation exposures[3]**	**Total**	**2017 Own funds requirement weights**	**2017 Countercyclical capital buffer rate**
Hong Kong	**178**	**27**	**–**	**–**	**–**	**–**	**7**	**–**	**–**	**7**	**0.05%**	**1.250%**
Norway	**3**	**50**	**–**	**–**	**–**	**–**	**7**	**–**	**–**	**7**	**0.05%**	**2.000%**
Sweden	**30**	**54**	**–**	**–**	**–**	**–**	**5**	**–**	**–**	**5**	**0.04%**	**2.000%**
Czech Republic	**–**	**8**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**0.00%**	**0.500%**
Iceland	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**0.00%**	**1.250%**
Slovakia	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**0.00%**	**0.500%**
i) Total[1]	**211**	**139**	**–**	**–**	**–**	**–**	**19**	**–**	**–**	**19**	**0.14%**	
United Kingdom	**27,181**	**479,808**	**376**	**332**	**1,067**	**18,494**	**11,094**	**43**	**283**	**11,420**	**85.17%**	**n/a**
United States of America	**2,559**	**11,983**	**–**	**–**	**–**	**5,733**	**572**	**–**	**42**	**614**	**4.58%**	**n/a**
Ireland	**932**	**4,081**	**–**	**–**	**–**	**10**	**374**	**–**	**4**	**378**	**2.81%**	**n/a**
Netherlands	**866**	**6,823**	**–**	**–**	**–**	**29**	**155**	**–**	**–**	**155**	**1.15%**	**n/a**
ii) Total[1]	**31,538**	**502,695**	**376**	**332**	**1,067**	**24,266**	**12,195**	**43**	**329**	**12,567**	**93.71%**	
iii) Rest of the World[1]	**3,566**	**15,582**	**–**	**–**	**–**	**1,107**	**807**	**–**	**14**	**821**	**6.15%**	
Total	**35,315**	**518,416**	**376**	**332**	**1,067**	**25,373**	**13,021**	**43**	**343**	**13,407**	**100.00%**	

	2016 General credit exposures[2,3]		2016 Trading book exposures[2,4]		2016 Securitisation exposures[3]		2016 Own funds requirements					
Breakdown by Country	Exposure Value for SA	Exposure Value for IRB	Sum of long and short positions of trading book exposures for SA	Value of trading book exposures for internal models	Exposure Value for SA	Exposure Value for IRB	of which: General credit exposures[2,3]	of which: Trading book exposures[2,4]	of which: Securitisation exposures[3]	Total	2016 Own funds requirement weights	2016 Countercyclical capital buffer rate
Norway	10	308	–	–	–	–	12	–	–	12	0.09%	1.500%
Sweden	48	65	–	–	–	–	5	–	–	5	0.04%	1.500%
Hong Kong	234	28	–	–	–	–	10	–	–	10	0.08%	0.625%
i) Total[1]	292	401	–	–	–	–	27	–	–	27	0.21%	
United Kingdom	19,100	485,137	134	90	1,184	18,505	11,244	16	250	11,510	84.14%	n/a
United States of America	2,442	12,828	–	–	–	6,743	639	–	57	696	5.09%	n/a
Ireland	1,133	4,609	–	–	–	24	402	–	4	406	2.97%	n/a
Netherlands	740	6,771	–	–	–	20	187	–	–	187	1.37%	n/a
ii) Total[1]	23,415	509,345	134	90	1,184	25,292	12,472	16	311	12,799	93.57%	
iii) Rest of the World[1]	3,408	15,985	–	–	–	1,117	838	–	16	854	6.22%	
Total	27,115	525,731	134	90	1,184	26,409	13,337	16	327	13,680	100.00%	

Amount of institution specific countercyclical capital buffer	**2017**	2016
Total risk exposure amount	**£210,919m**	£215,534m
Institution specific countercyclical buffer rate	**0.002%**	0.002%
Institution specific countercyclical buffer requirement	**£5.2m**	£5.0m

1 The breakdown by country is disclosed on the following basis:
i) those countries for which a countercyclical capital buffer rate has been set.
ii) those countries for which a countercyclical capital buffer rate has not been set and have an own funds requirement weighting of greater than or equal to one per cent, the threshold having been determined by the Group in accordance with the EBA guidelines on materiality for Pillar 3.
iii) the aggregate of all remaining countries for which a countercyclical buffer rate has not been set and individually have an own funds requirement weighting of less than one per cent.

2 For the purposes of the calculation of the countercyclical capital buffer, general credit risk and trading book exposures exclude exposures to central governments, central banks, regional governments, local authorities, public sector entities, multilateral development banks, international organisations and institutions. In addition, trading book exposures are limited to those that are subject to the own funds requirement for specific risk or incremental default and migration risk.

3 General credit and securitisation exposures include counterparty credit risk and are stated on a post CRM basis.

4 Trading book exposures are allocated in full to the United Kingdom in accordance with the threshold criteria set out under the EBA Regulatory Technical Standard on the identification of the geographical location of the relevant credit exposures for the calculation of the countercyclical capital buffer.

Appendix 2: Asset encumbrance

Table 87: Asset Encumbrance

	2017 Carrying amount of encumbered assets £m	2017 Fair value of encumbered assets £m	2017 Carrying amount of unencumbered assets £m	2017 Fair value of unencumbered assets £m	2016 Carrying amount of encumbered assets £m	2016 Fair value of encumbered assets £m	2016 Carrying amount of unencumbered assets £m	2016 Fair value of unencumbered assets £m
Encumbered and unencumbered assets[1]								
Total assets	**149,653**		**528,516**		148,158		539,791	
Equity instruments	**–**		**2,044**		–		2,063	
Debt securities[2]	**30,267**	**30,267**	**39,691**	**39,691**	33,233	33,233	47,793	47,793
of which: covered bonds	**3**	**3**	**866**	**866**				
of which: asset-backed securities	**1,113**	**1,113**	**2,042**	**2,042**				
of which: issued by general governments	**29,699**	**29,699**	**23,802**	**23,802**				
of which: issued by financial corporations	**1,569**	**1,569**	**13,009**	**13,009**				
of which: issued by non-financial corporations	**10**	**10**	**2,155**	**2,155**				
Other assets[3]	**118,293**		**485,736**		114,745		489,639	

Collateral received[1]	2017 Fair value of encumbered collateral received or own debt securities issued £m	2017 Fair value of collateral received or own debt securities issued available for encumbrance £m
Collateral received	47,460	51,943
Loans on demand	–	–
Equity Instruments	–	–
Debt securities	47,460	48,309
of which: covered bonds	7	7
of which: asset-backed securities	–	–
of which: issued by general governments	47,251	48,134
of which: issued by financial corporations	208	120
of which: issued by non-financial corporations	1	67
Loans and advances other than loans on demand	–	3,793
Other collateral received	–	–
Own debt securities issued other than own covered bonds or asset-backed securities	–	–
Own covered bonds and asset-backed securities issued and not yet pledged		13,377
Total assets, collateral received and own debt securities issued	197,721	

Sources of Encumbrance[1]	2017 Matching liabilities, contingent liabilities or securities lent £m	2017 Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m	2016 Matching liabilities, contingent liabilities or securities lent £m	2016 Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities[4]	**133,266**	**122,738**	133,703	132,204

1 The reported values represent the median of the values reported to the regulator via quarterly supervisory returns over the period 31 March 2017 to 31 December 2017.

2 Includes debt securities accounted for as trading and other financial assets at fair value through profit or loss, loans and receivables and AFS financial assets.

3 All remaining regulatory balance sheet assets, including loans on demand and other loans and advances. The carrying amount of other encumbered assets predominantly reflects other loans and advances.

4 Consists of derivatives, deposits and debt securities issued.

Appendix 2: Asset encumbrance continued

Asset encumbrance

The Board and Group Asset and Liability Committee monitor and manage total balance sheet encumbrance via a number of risk appetite metrics. The amount of encumbered assets has been broadly stable over 2017. The vast majority of assets encumbered are in the UK banking entities, with the Group primarily encumbering mortgages, unsecured lending and credit card receivables through the issuance programmes (covered bonds and securitisation) and tradable securities through securities financing activity (repo and stock lending). 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 also separately identifies unencumbered assets which are available to meet any future possible funding requirements, further details are included on pages 148 and 149 of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

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, mandates are credit rating driven with appropriate notional limits per rating, asset and individual bond concentration. 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.

Appendix 3: Differences in the accounting and regulatory scopes of consolidation

Table 88: Outline of the differences between the accounting and regulatory scopes of consolidation (LI3)[1,2]

		2017				
		Method of regulatory consolidation				
Name of the entity	Method of accounting consolidation	Full consolidation	Proportional consolidation	Neither consolidated nor deducted	Deducted	Description of entity
Associates[3]						
BIG SOCIETY CAPITAL LIMITED	Equity			X		Activities auxiliary to financial services and insurance activities
BLUESTONE CONSOLIDATED HOLDINGS LTD	Venture Capital Investment		X			Financial service activities, except insurance and pension funding
MOTABILITY OPERATIONS GROUP PLC	Equity				X	Rental and leasing activities
TRAVELLERS CHEQUE ASSOCIATES LTD	Equity		X			Financial service activities, except insurance and pension funding
Securitisation SPEs[4]						
CHELTENHAM SECURITIES 2017 LIMITED	Full Consolidation			X		Special Purpose Entity
FONTWELL SECURITIES 2016 LTD	Full Consolidation			X		Special Purpose Entity
HART 2014-1 LTD	Full Consolidation			X		Special Purpose Entity
LEICESTER SECURITIES 2014 LTD	Full Consolidation			X		Special Purpose Entity
SALISBURY II SECURITIES 2016 LTD	Full Consolidation			X		Special Purpose Entity
SALISBURY II-A SECURITIES 2017 LIMITED	Full Consolidation			X		Special Purpose Entity
SALISBURY SECURITIES 2015 LTD	Full Consolidation			X		Special Purpose Entity
WETHERBY SECURITIES 2017 LIMITED	Full Consolidation			X		Special Purpose Entity
CANCARA ASSET SECURITISATION LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 1) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 3) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 10) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 11) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 12) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 13) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 14) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 15) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 16) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 19) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 20) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 21) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 22) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 23) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 24) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 25) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 26) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 27) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 28) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 29) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 30) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 31) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 32) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 33) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 34) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 35) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 36) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 37) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 38) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 39) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 40) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 41) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 42) LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 44) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 45) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 46) UK LTD	Full Consolidation			X		Special Purpose Entity
GRESHAM RECEIVABLES (NO. 47) UK LIMITED	Full Consolidation			X		Special Purpose Entity

Appendix 3: Differences in the accounting and regulatory scopes of consolidation continued

Name of the entity	Method of accounting consolidation	Method of regulatory consolidation				Description of entity
		Full consolidation	Proportional consolidation	Neither consolidated nor deducted	Deducted	
Insurance subsidiaries[5]						
SCOTTISH WIDOWS LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
CLERICAL MEDICAL (DARTFORD NUMBER 2) LTD	Full Consolidation				X	Non-Trading Company
CLERICAL MEDICAL (DARTFORD NUMBER 3) LTD	Full Consolidation				X	Non-Trading Company
CLERICAL MEDICAL FORESTRY LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
CLERICAL MEDICAL INTERNATIONAL HOLDINGS B.V.	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
CLERICAL MEDICAL MANAGED FUNDS LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
CLERICAL MEDICAL NON STERLING PROPERTY COMPANY SARL	Full Consolidation				X	Financial service activities, except insurance and pension funding
CLERICAL MEDICAL PROPERTIES LTD	Full Consolidation				X	Real estate activities
CM VENTURE INVESTMENTS LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
CMI INSURANCE (LUXEMBOURG) S.A	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
DALKEITH CORPORATION	Full Consolidation				X	Financial service activities, except insurance and pension funding
FONTVIEW LTD	Full Consolidation				X	Non-Trading Company
FRANCE INDUSTRIAL PREMISES HOLDING COMPANY	Full Consolidation				X	Financial service activities, except insurance and pension funding
HALIFAX EQUITABLE LTD	Full Consolidation				X	Non-Trading Company
HALIFAX GENERAL INSURANCE SERVICES LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
HALIFAX LIFE LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
HBOS INTERNATIONAL FINANCIAL SERVICES HOLDINGS LTD	Full Consolidation				X	Activities of head offices; management consultancy activities
INDUSTRIAL REAL ESTATE (GENERAL PARTNER) LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
INDUSTRIAL REAL ESTATE (NOMINEE) LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
LLOYDS BANK GENERAL INSURANCE HOLDINGS LTD	Full Consolidation				X	Activities of head offices; management consultancy activities
LLOYDS BANK GENERAL INSURANCE LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
LLOYDS BANK INSURANCE SERVICES (DIRECT) LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
LLOYDS BANK INSURANCE SERVICES LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
NEWFONT LTD	Full Consolidation				X	Non-Trading Company
OYSTERCATCHER NOMINEES LTD	Full Consolidation				X	Office administrative, office support and other business support activities
OYSTERCATCHER RESIDENTIAL LTD	Full Consolidation				X	Office administrative, office support and other business support activities
PENSIONS MANAGEMENT (S.W.F.) LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
SAINT MICHEL HOLDING COMPANY NO1	Full Consolidation				X	Financial service activities, except insurance and pension funding
SAINT MICHEL INVESTMENT PROPERTY	Full Consolidation				X	Financial service activities, except insurance and pension funding
SAINT WITZ 2 HOLDING COMPANY NO1	Full Consolidation				X	Financial service activities, except insurance and pension funding
SAINT WITZ 2 INVESTMENT PROPERTY	Full Consolidation				X	Financial service activities, except insurance and pension funding
SCOTTISH WIDOWS (PORT HAMILTON) LTD	Full Consolidation				X	Real estate activities
SCOTTISH WIDOWS ACTIVE MANAGEMENT FUND	Full Consolidation				X	Real estate activities
SCOTTISH WIDOWS ANNUITIES LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
SCOTTISH WIDOWS FINANCIAL SERVICES HOLDINGS	Full Consolidation				X	Activities of head offices; management consultancy activities
SCOTTISH WIDOWS FUND AND LIFE ASSURANCE SOCIETY	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
SCOTTISH WIDOWS FUND MANAGEMENT LTD	Full Consolidation				X	Non-Trading Company

Appendix 3: Differences in the accounting and regulatory scopes of consolidation continued

Name of the entity	Method of accounting consolidation	Method of regulatory consolidation: Full consolidation	Proportional consolidation	Neither consolidated nor deducted	Deducted	Description of entity
SCOTTISH WIDOWS GROUP LTD	Full Consolidation				X	Activities of head offices; management consultancy activities
SCOTTISH WIDOWS INDUSTRIAL PROPERTIES EUROPE B.V.	Full Consolidation				X	Real estate activities
SCOTTISH WIDOWS PROPERTY MANAGEMENT LTD	Full Consolidation				X	Real estate activities
SCOTTISH WIDOWS TRUSTEES LTD	Full Consolidation				X	Office administrative, office support and other business support activities
SCOTTISH WIDOWS UNIT FUNDS LTD	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
ST ANDREW'S GROUP LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
ST ANDREW'S INSURANCE PLC	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
ST ANDREW'S LIFE ASSURANCE PLC	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
SW FUNDING PLC	Full Consolidation				X	Insurance, reinsurance and pension funding, except compulsory social security
SW NO.1 LTD	Full Consolidation				X	Financial service activities, except insurance and pension funding
SWAMF (GP) LIMITED	Full Consolidation				X	Office administrative, office support and other business support activities
SWAMF NOMINEE (1) LTD	Full Consolidation				X	Office administrative, office support and other business support activities
SWAMF NOMINEE (2) LTD	Full Consolidation				X	Office administrative, office support and other business support activities
WAVERLEY - FUND II INVESTOR LLC	Full Consolidation				X	Financial service activities, except insurance and pension funding
WAVERLEY - FUND III INVESTOR LLC	Full Consolidation				X	Financial service activities, except insurance and pension funding
CELSIUS EUROPEAN LUX 2 SARL	Full Consolidation				X	Special Purpose Entity
CLERICAL MEDICAL NON STERLING ARTS FSA	Full Consolidation				X	Special Purpose Entity
CLERICAL MEDICAL NON STERLING ARTS LSA	Full Consolidation				X	Special Purpose Entity
CLERICAL MEDICAL NON STERLING GUADALIX HOLD CO BV	Full Consolidation				X	Special Purpose Entity
CLERICAL MEDICAL NON STERLING GUADALIX SPANISH PROP CO SL	Full Consolidation				X	Special Purpose Entity
CLERICAL MEDICAL NON STERLING MEGAPARK HOLD CO BV	Full Consolidation				X	Special Purpose Entity
CLERICAL MEDICAL NON STERLING MEGAPARK PROP CO SA	Full Consolidation				X	Special Purpose Entity
SARL COLISEUM	Full Consolidation				X	Special Purpose Entity
SARL FONCIERE DE RIVES	Full Consolidation				X	Special Purpose Entity
SARL HIRAM	Full Consolidation				X	Special Purpose Entity
SAS COMPAGNIE FONCIERE DE FRANCE	Full Consolidation				X	Special Purpose Entity
SCI ASTORIA INVEST	Full Consolidation				X	Special Purpose Entity
SCI DE L'HORLOGE	Full Consolidation				X	Special Purpose Entity
SCI EQUINOXE	Full Consolidation				X	Special Purpose Entity
SCI MERCURY INVEST	Full Consolidation				X	Special Purpose Entity
SCI MILLENIUM AP1	Full Consolidation				X	Special Purpose Entity
SCI NORLI	Full Consolidation				X	Special Purpose Entity
SCI RAMBUTEAU CFF	Full Consolidation				X	Special Purpose Entity
THISTLE INVESTMENTS (AMC) LTD	Full Consolidation				X	Special Purpose Entity
THISTLE INVESTMENTS (ERM) LTD	Full Consolidation				X	Special Purpose Entity

1 The regulatory treatment of all entities listed as subsidiaries in the 2017 Lloyds Banking Group plc Annual Report and Accounts, pages 268 to 270, follows the accounting treatment unless otherwise stated in the table below.

2 Collective Investment Vehicles, as listed in the 2017 Lloyds Banking Group plc Annual Report and Accounts, page 273, are excluded from the regulatory scope of consolidation.

3 Associated undertakings, as listed in the 2017 Lloyds Banking Group plc Annual Report and Accounts, pages 270 to 272, are, unless otherwise stated in the list above, predominantly a mix of private equity investments, to which the venture capital exemption applies, and associates and joint ventures that are excluded from the regulatory scope of consolidation. The private equity investments are accounted for as FVTPL for accounting purposes and are equity risk weighted for regulatory purposes.

4 The Group's capital-efficient securitisations and conduit vehicles are fully consolidated for accounting purposes. The underlying assets of the capital-efficient securitisations have been de-recognised from the regulatory balance sheet and replaced with the retained securitisation positions, risk weighted in line with the securitisation framework. The conduit vehicles are deconsolidated for regulatory purposes and the corresponding liquidity lines are risk-weighted, as further described in the Securitisation section, pages 79 to 87.

5 All Insurance subsidiaries, other than those identified as investment firms or asset management companies, are excluded from the regulatory scope of consolidation and are classified as 'deducted', as they form part of the Insurance Group headed by Scottish Widows Limited. The debt and equity investments held by the Group in Scottish Widows Limited are deducted from capital, subject to thresholds, as described on page 114, Notes 10 and 14.

Appendix 4: New quantitative templates

	Table	Abbreviation	Full Name	Page	Year template adopted 2016	2017
	1	KM1	Key Metrics	3		x
	2	LI1	Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories	8	x	
	3	LI2	Main sources of differences between regulatory exposure amounts and carrying values in financial statements	10	x	
*	8	OV1	Overview of risk-weighted assets	26	x	
*	10	CR8	Risk-weighted assets flow statements of credit risk exposures	31	x	
	12	CR3	CRM techniques – Overview	35		x
	16	CR9	Back-testing of PD per portfolio – Mortgages	42	x	
	17	CR9	Back-testing of PD per portfolio – QRRE	43	x	
	18	CR9	Back-testing of PD per portfolio – Retail Other (Non SME)	44	x	
	19	CR9	Back-testing of PD per portfolio – Retail SME	45	x	
	20	CR9	Back-testing of PD per portfolio – Ireland Mortgages	46	x	
	21	CR9	Back-testing of PD per portfolio – Corporate Main	47	x	
	22	CR9	Back-testing of PD per portfolio – Corporate SME	48	x	
	23	CRB-B	Total and average net amount of exposures	49		x
*	24	CR6	IRB – Credit risk exposures by portfolio and PD range – Central governments or central banks	52	x	
*	25	CR6	IRB – Credit risk exposures by portfolio and PD range – Institutions	53	x	
*	26	CR6	IRB – Credit risk exposures by portfolio and PD range – Corporate Main	54	x	
*	27	CR6	IRB – Credit risk exposures by portfolio and PD range – Corporate SME	55	x	
*	28	CR6	IRB – Credit risk exposures by portfolio and PD range – Residential mortgages (SME)	56	x	
*	29	CR6	IRB – Credit risk exposures by portfolio and PD range – Residential mortgages (non-SME)	57	x	
*	31	CR6	IRB – Credit risk exposures by portfolio and PD range – QRRE	59	x	
*	32	CR6	IRB – Credit risk exposures by portfolio and PD range – Other SME	60	x	
*	33	CR6	IRB – Credit risk exposures by portfolio and PD range – Other non-SME	61	x	
*	34A	CR10	IRB – Specialised lending	62	x	
*	34B	CR10	Equity exposures subject to the simple risk weight method	63	x	
*	36	CR4	Standardised approach – credit risk exposure and Credit Risk Mitigation (CRM) effects	65		x
*	37	CR5	Standardised approach – exposures by asset class	66		x
	38	CRB-C	Geographical breakdown of exposures	67		x
	40	CRB-D	Concentration of exposures by industry	70		x
	41	CRB-E	Maturity of exposures	72		x
	42	CR1-A	Credit quality of exposures by exposure class and instrument	75		x
	43	CR1-B	Credit quality of exposures by industry types	76		x
	44	CR1-C	Credit quality of exposures by geography	76		x
	46	CR1-D (hybrid)	Ageing of performing and non-performing exposures	77		x
	47	CR1-E	Non-performing and foreborne exposures	77		x
	58	CCR1	Analysis of CCR exposure by approach	92		x
	59	CCR8	Exposures to CCPs	93		x
*	60	CCR2	Credit valuation adjustment (CVA) capital charge	93	x	
*	62	CCR4	IRB – CCR exposure by portfolio and PD scale – Corporate Main	95	x	
*	63	CCR4	IRB – CCR exposure by portfolio and PD scale – Central governments or central banks exposures	96	x	
*	64	CCR4	IRB – CCR exposure by portfolio and PD scale – Institutions	97	x	
*	66	CCR3	Standardised approach – CCR exposures by regulatory portfolio and risk	99	x	
	68	CCR5-A	Impact of netting and collateral held on exposure values	100		x
	69	CCR6	Credit derivatives exposures	100	x	
*	74	MR4	Comparison of VaR estimates with gains/losses	106	x	
*	75	MR3	IMA values for trading portfolios	107	x	
*	76	MR2-A	Market risk under internal models approach	108	x	
*	77	MR2-B	Risk-weighted assets flow statements of market risk exposures under an IMA	108	x	
*	78	MR1	Market risk under Standardised approach	109	x	
	79	LIQ1	Liquidity Coverage Ratio	112		x
	82	PV1	Prudent valuation adjustments	117		x
	88	LI3	Outline of the differences between the accounting and regulatory scopes of consolidation	123		x

* The new quantitative templates that were disclosed at June 2017.

Appendix 4: New quantitative templates continued

Of the quantitative EBA templates required to be disclosed in full from 31 December 2017 there are some that are not applicable to the Group. These include INS1 (Non-deducted participations in insurance undertakings), CCR7 (RWA flow statements of CCR exposures under the IMM) and CCR5-B (Composition of collateral for exposures to CCR). Regarding CCR5-B template, the PRA introduced a waiver for firms where the fair value of collateral received or the fair value of collateral posted in the form of debt securities does not exceed £100 billion (using quarterly data) and the Group is below this threshold. CR2-A template (Changes in the stock of general and specific credit risk adjustments) requirement is met through the disclosure of Note 20 (Allowance for impairment losses on loans and receivables) of the 2017 Lloyds Banking Group plc Annual Report and Accounts.

Appendix 5: CRR mapping

CRR ref	High-level summary	Pillar 3	ARA	Compliance reference
Scope of disclosure requirements				
431 (1)	Requirement to publish Pillar 3 disclosures.	x		Lloyds Banking Group publishes Pillar 3 disclosures.
431 (2)	Firms with permission to use specific operational risk methodologies must disclose operational risk information.		x	Pages 135-136 (Operational Risk) The Group's operational risk systems, mitigation and approach are disclosed in the Risk Management Section.
431 (3)	Institution must have a policy covering frequency of disclosures, their verification, comprehensiveness and appropriateness. Institution must also have policies for assessing whether their disclosures convey their risk profile comprehensively to market participants.	x		Pages 5-6 (Disclosure Policy) Lloyds Banking Group has a Pillar 3 Disclosure Policy. Page 11 (The Group's Approach to Risk)
431 (4)	Explanation of ratings decision upon request.			Not applicable
Non-material, proprietary or confidential information				
432 (1)	Institutions may omit information that is not material if certain conditions are respected.	x		Page 5 (Basis of Preparation) Limited disclosure on Trading Book securitisations given its relative materiality.
432 (2)	Institutions may omit information that is proprietary or confidential if certain conditions are respected.			Not applicable
432 (3)	Where 432 (2) applies this must be stated in the disclosures, and more general information must be disclosed.			Not applicable
432 (4)	Use of 432 (1), (2) or (3) is without prejudice to scope of liability for failure to disclose material information.			Not applicable
Frequency of disclosure				
433	Disclosures must be published once a year at a minimum and more frequently if necessary.	x		Page 5 (Frequency, media and location)
Means of disclosure				
434 (1)	To include all disclosures in one appropriate medium, or provide clear cross-references.	x		Page 5 (Frequency, media and location) Most disclosures are contained within this document.
434 (2)	Disclosures made under other requirements (e.g. accounting) can be used to satisfy Pillar 3 if appropriate.	x		Any cross-references to accounting or other disclosures are clearly signposted in this document where appropriate.
Risk management objectives and policies				
435 (1)	Disclose information on:			
435 (1) (a)	The strategies and processes to manage risks		x	Pages 107-156 (Risk Management Section)
435 (1) (b)	Structure and organisation of risk management function		x	Page 111 (How risk is managed in Lloyds Banking Group)
435 (1) (c)	Risk reporting and measurement systems		x	Pages 107-156 (Risk Management Section)
435 (1) (d)	Hedging and mitigating risk – policies and processes		x	Pages 107-156 (Risk Management Section)
435 (1) (e)	A declaration of adequacy of risk management arrangements approved by the Board		x	Page 67 (Corporate Governance Report) Reference to this is made on page 4 of the Pillar 3 disclosures (Introduction).
435 (1) (f)	Concise risk statement approved by the Board.			
435 (2)	Information on governance arrangements, including information on Board composition and recruitment and risk committees.		x	Pages 58-80 (Corporate Governance Report) Page 113 (Risk Governance)
435 (2) (a)	Number of directorships held by Board members		x	Pages 54-55 (Board of Directors)
435 (2) (b)	Recruitment policy for selection of Board members, their actual knowledge, skills and expertise.		x	Pages 54-55 (Board of Directors)
435 (2) (c)	Policy on diversity of Board membership and results against targets.		x	Page 72 (Corporate Governance Report)
435 (2) (d)	Disclosure of whether a dedicated risk committee is in place, and number of meeting in the year.		x	Page 77 (Board Risk Committee Report)
435 (2) (e)	Description of information flow on risk to Board.		x	Pages 113-115 (Risk Governance)
Scope of application				
436 (a)	Name of institution.	x		Page 4 (Introduction)
436 (b)	Difference in basis of consolidation for accounting and prudential purposes, describing entities that are:	x		Page 7 (Scope of Consolidation) Details of the scope of consolidation applied to Lloyds Banking Group are outlined in the diagram referred to on page 7.
436 (b) (i)	Fully consolidated;			
436 (b) (ii) 436 (b) (iii)	Proportionally consolidated;			
436 (b) (iv)	Deducted from own funds;			
436 (c)	Impediments to transfer of own funds between parent and subsidiaries.			Not applicable
436 (d)	Capital shortfalls in any subsidiaries outside the scope of consolidation.		x	Pages 137-144 (Capital Risk) The Group actively manages the capital of its subsidiaries to ensure these remain appropriately capitalised.

Appendix 5: CRR mapping continued

CRR ref	High-level summary	Pillar 3	ARA	Compliance reference
436 (e)	Making use of articles on derogations from a) prudential requirements or b) liquidity requirements for individual subsidiaries/entities.	x		Page 7 (Scope of Consolidation) LBG makes use of these provisions according to its waiver from the PRA.
Own funds				
437 (1)	Disclose the following information regarding own funds:			
437 (1) (a)	a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and filters and deductions applied pursuant to Articles 32 to 35, 36, 56, 66 and 79 to own funds of the institution and the balance sheet in the audited financial statements of the institution;	x		Pages 113-114 (Own funds reconciliation)
437 (1) (b)	a description of the main features of the Common Equity Tier 1 and Additional Tier 1 instruments and Tier 2 instruments issued by the institution;			Separately disclosed on Group website http://www.lloydsbankinggroup.com/investors/financial-performance/other-disclosures/
437 (1) (c)	the full terms and conditions of all Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments;			Separately disclosed on Group website http://www.lloydsbankinggroup.com/investors/financial-performance/other-disclosures/
437 (1) (d)	disclosure of the nature and amounts of the following:	x		Pages 113-114 (Own funds reconciliation)
437 (1) (d) (i)		x		
437 (1) (d) (ii)	each deduction made pursuant to Articles 36, 56 and 66;	x		
437 (1) (d) (iii)	items not deducted in accordance with	x		
	Articles 47, 48, 56, 66 and 79;	x		
437 (1) (e)	a description of all restrictions applied to the calculation of own funds in accordance with this Regulation and the instruments, prudential filters and deductions to which those restrictions apply;	x		
437 (1) (f)	where institutions disclose capital ratios calculated using elements of own funds determined on a different basis.			Not applicable
Capital requirements				
438 (a)	Summary of institution's approach to assessing adequacy of capital levels.	x		Page 20 (The Group's approach to Capital Risk)
438 (b)	Result of ICAAP on demand from authorities.			Not applicable
438 (c)	Capital requirements for each Standardised approach credit risk exposure class.	x		Pages 49-50 (Table 23: Total and average net amount of exposures – CRB-B)
438 (d)	Capital requirements for each Internal Ratings Based Approach credit risk exposure class.			
438 (e)	Capital requirements for market risk or settlement risk.	x		Page 99 (Table 70: Market risk own funds requirements)
438 (f)	Capital requirements for operational risk, separately for the Basic Indicator Approach, the Standardised Approach, and the Advanced Measurement Approaches as applicable.	x		Page 108 (Operational Risk)
438 (endnote)	Requirement to disclose specialised lending exposures and equity exposures in the banking book falling under the simple risk weight approach.	x		Page 62 (Table 34A: IRB – Specialised lending (CR10)) and Page 63 (Table 34B: Equity exposures subject to the simple risk weight method (CR10))
Exposure to counterparty credit risk (CCR)				
439 (a)	Description of process to assign internal capital and credit limits to CCR exposures.	x		Page 89 (Internal capital and credit limits)
439 (b)	Discussion of policies for securing collateral and establishing credit reserves.	x		Page 89 (Securing collateral and establishing credit reserves)
439 (c)	Discussion of management of wrong-way risk exposures.	x		Page 89 (Correlation (Wrong Way) Risk)
439 (d)	Disclosure of collateral to be provided (outflows) in the event of a ratings downgrade.	x		Page 89 (Collateral requirements in the event of a downgrade in credit rating)
439 (e)	Derivation of net derivative credit exposure.	x		Page 98 (Net derivatives credit exposure, including Table 68: Impact of netting and collateral held on exposure value (CCR5-A))
439 (f)	Exposure values for mark-to-market, original exposure, standardised and internal model methods.	x		Page 90 (Table 58: Analysis of CCR exposure by approach (CCR1))
439 (g)	Notional value of credit derivative hedges and current credit exposure by type of exposure.	x		Page 98 (Notional value of credit derivative transactions, including Table 69: Credit derivatives exposures (CCR6))
439 (h)	Notional amounts of credit derivative transactions.	x		
439 (i)	Estimate of alpha, if applicable.			Not applicable

Appendix 5: CRR mapping continued

CRR ref	High-level summary	Pillar 3	ARA	Compliance reference
Capital buffers				
440 (1) (a)	Geographical distribution of relevant credit exposures for calculation of countercyclical capital buffer.	x		Page 118 (Table 86: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer)
440 (1) (b)	Amount of the institution specific countercyclical capital buffer.			
Indicators of global systemic importance				
441 (1)	Disclosure of the indicators of global systemic importance.			The Group's G-SIB metrics are separately disclosed on the Group's website. http://www.lloydsbankinggroup.com/investors/financial-performance/other-disclosures/
Credit risk adjustments				
442 (a)	Disclosure of bank's definitions of past due and impaired.	x		Page 73 (Past due exposures, impaired exposures and impairment provisions)
442 (b)	Approaches for calculating specific and general credit risk adjustments.	x		Page 76 (Comparison of expected losses to specific credit risk adjustments)
442 (c)	Disclosure of pre-CRM EAD by exposure class.	x		Pages 49-50 (Table 23: Total and average net amount of exposures (CRB-B))
442 (d)	Disclosure of pre-CRM EAD by geography and exposure class.	x		Pages 66-67 (Table 38: Geographical breakdown of exposures (CRB-C))
442 (e)	Disclosure of pre-CRM EAD by industry and exposure class.	x		Pages 69-70 (Table 40: Concentration of exposures by industry (CRB-D))
442 (f)	Disclosure of pre-CRM EAD by residual maturity and exposure class.	x		Pages 71-72 (Table 41: Maturity of exposures (CRB-E))
442 (g) (i), (ii), (iii)	Breakdown of impaired, past due, specific and general credit risk adjustments, and impairment charges for the period, by industry.	x		Page 75 (Table 43: Credit quality of exposures by industry types (CR1-B)) Page 75 (Table 45: Past due but not impaired loans and advances analysed by major industrial sector)
442 (h)	Impaired, past due exposures, by geographical area, and amounts of specific and general impairment for each geography.	x		Page 75 (Table 44: Credit quality of exposures by geography (CR1-C)) Page 75 (Analysis of past due, non-performing and forborne exposures)
442 (i), (ii), (iii), (iv), (v)	Reconciliation of changes in specific and general credit risk adjustments for impaired exposures.		x	Page 196 (Note 20: Allowance for impairment losses on loans and receivables)
442 (endnote)	Specific credit risk adjustments recorded to income statement are disclosed separately.			
Unencumbered assets				
443	Disclosures on unencumbered assets.	x		Pages 119 and 120 (Appendix 2: Asset encumbrance)
Use of ECAIs				
444 (a)	Names of the ECAIs used in the calculation of Standardised approach risk-weighted assets and reasons for any changes.	x		Page 65 (Table 37: Standardised approach – exposures by asset class (CR5))
444 (b)	Exposure classes associated with each ECAI.	x		
444 (c)	Description of the process used to transfer credit assessments to non-trading book items.	x		
444 (d)	Mapping of external rating to CQS.			Not applicable. The Group complies with the standard association published on the EBA website
444 (e)	Exposure value pre and post-credit risk mitigation, by CQS.	x		Page 64 (Table 36: Standardised approach – credit risk exposures and Credit Risk Mitigation (CRM) effects (CR4)) Page 65 (Table 37: Standardised approach – exposures by asset class (CR5))
Exposure to market risk				
445	Disclosure of position risk, large exposures exceeding limits, FX, settlement and commodities risk.	x		Pages 99-107 (Market risk)
Operational risk				
446	Scope of approaches used to calculate operational risk.	x		Page 15 (Pillar 1 Capital Requirements)
Exposure in equities not included in the trading book				
447 (a)	Differentiation of exposures based on objectives and an overview of accounting techniques and valuation methodologies.	x		Page 63 (Non-trading book exposures in equities) The appropriate cross referencing to the ARA is outlined in this section.
447 (b)	The balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the fair value.	x		Page 63 (Table 35: Analysis of non-trading book exposures in equities)

Appendix 5: CRR mapping continued

CRR ref	High-level summary	Pillar 3	ARA	Compliance reference
447 (c)	The types, nature and amounts of exchange-traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures.	x		Page 63 (Non-trading book exposures in equities)
447 (d)	Realised gains or losses arising from sales and liquidations in the period.	x		Page 63 (Table 35: Analysis of non-trading book exposures in equities)
447 (e)	Total unrealised gains or losses, the total latent revaluation gains or losses, and any of these amounts included in the original or additional own funds.	x		
Exposure to interest rate risk on positions not included in the trading book				
448 (a)	Nature of the interest rate risk and the key assumptions, and frequency of measurement of the interest rate risk.		x	Pages 152-154 (Banking activities)
448 (b)	Variation in earnings, economic value or other relevant measure used by the bank for upward and downward rate shocks according to the banks method for measuring the interest rate risk, broken down by currency.			
Exposure to securitisation positions				
449 (a)	Objectives in relation to securitisation activity.	x		Page 80 (Banking book securitisation strategy and roles)
449 (b)	Nature of other risks in securitised assets, including liquidity.	x		Page 80 (Trading book securitisation strategy and roles) and Page 82 (Risks inherent in banking book securitised assets)
449 (c)	Risks in re-securitisation activity stemming from seniority of underlying securitisations and ultimate underlying assets.			Not applicable
449 (d)	The roles played by the institution in the securitisation process.	x		Page 80 (Banking book securitisation strategy and roles)
449 (e)	Indication of the extent of involvement in roles.	x		Page 81 (Table 49: Summary of securitisation exposures and capital requirements)
449 (f)	Processes in place to monitor changes in credit and market risks of securitisation exposures, and how the processes differ for re-securitisation exposures.	x		Page 82 (Monitoring changes in the credit risk of securitised exposures and Monitoring changes in the credit risk of ABS portfolios)
449 (g)	Description of the institution's policies with respect to hedging and unfunded protection, and identification of material hedge counterparties.	x		Page 85 (Use of credit derivatives and guarantees)
449 (h)	Approaches to the calculation of risk-weighted assets for securitisations mapped to types of exposures.	x		Page 81 (Table 49: Summary of securitisation exposures and capital requirements)
449 (i)	Types of SSPEs used to securitise third-party exposures as a sponsor.	x		Page 85 (Sponsored and invested securitisations)
449 (j) (i-vi)	Summary of accounting policies for securitisations.	x		Page 84 (Accounting treatment)
449 (k)	Names of ECAIs used for securitisations and type.	x		Page 83 (Originated securitisations – regulatory treatment) Page 86 (Capital assessment)
449 (l)	Full description of Internal Assessment Approach.	x		Page 86 (Capital assessment)
449 (m)	Explanation of significant changes in quantitative disclosures.	x		Key movements explained where applicable under relevant tables
449 (n)	As appropriate, separately for the Banking and trading book securitisation exposures:			
449 (n) (i)	Amount of outstanding exposures securitised;	x		Page 81 (Table 49: Summary of securitisation exposures and capital requirements)
449 (n) (ii)	On balance sheet securitisation retained or purchased, and off balance sheet exposures;	x		Pages 83 and 84 (Table 52: Analysis of originated positions under the RBA by risk weight category and Table 53: Analysis of originated positions under Standardised approach by risk weight category) Page 86 (Table 54: Analysis of sponsored positions by risk weight category) Page 87 (Table 55: Analysis of invested positions by risk weight category)
449 (n) (iii)	Amount of assets awaiting securitisation;	x		Page 85 (Assets awaiting securitisation)
449 (n) (iv)	Early amortisation treatment; aggregate drawn exposures, capital requirements.			Not applicable
449 (n) (v)	Deducted or 1,250%-weighted securitisation positions.	x		Page 81 (Table 49: Summary of securitisation exposures and capital requirements)
449 (n) (vi)	Securitisation activity including the amount of exposures securitised and recognised gains or losses on sales;	x		Page 81 (Securitisation programmes and activity)

Appendix 5: CRR mapping continued

CRR ref	High-level summary	Pillar 3	ARA	Compliance reference
449 (o)	Banking and trading book securitisations.	x		Pages 83 and 84 (Table 52: Analysis of originated positions under the RBA by risk weight category and Table 53: Analysis of originated positions under Standardised approach by risk weight category)
449 (o) (i)	Retained and purchased positions and associated capital requirements, broken down by risk-weight bands.	x		Page 86 (Table 54: Analysis of sponsored positions by risk weight category) Page 87 (Table 55: Analysis of invested positions by risk weight category)
449 (o) (ii)	Retained and purchased re-securitisation positions before and after hedging and insurance; exposure to financial guarantors broken down by guarantor credit worthiness.			Not applicable
449 (p)	Impaired assets and recognised losses related to banking book securitisations, by exposure type.	x		Page 83 (Table 51: Analysis of gross securitised exposures on a regulatory basis)
449 (q)	Exposure and capital requirements for trading book securitisations, separated into traditional and synthetic.	x		Page 82 (Table 50: Value of exposures of retained and purchased positions in the banking and trading book by exposure type)
449 (r)	Whether the institution has provided non-contractual financial support to securitisation vehicles.			Not applicable
Remuneration disclosure				
450	Remuneration disclosures (Material Risk Takers).		x	Pages 100-102 (Directors' remuneration policy) and pages 103-106 (Other remuneration disclosures)
Leverage				
451 (1) (a) 451 (1) (b) 451 (1) (c)	Leverage ratio, and breakdown of total exposure measure, including reconciliation to financial statements, and derecognised fiduciary items.	x		Page 24 (Table 6: Leverage ratio) Page 116 (Table 83: Leverage ratio common disclosure and Table 84: Summary reconciliation of accounting assets and leverage ratio exposures) Page 117 (Table 85: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures))
451 (1) (d) 451 (1) (e)	Description of the processes used to manage the risk of excessive leverage, and factors that impacted the leverage ratio during the year.	x		Page 117 (Description of the processes used to manage the risk of excessive leverage)
Use of the IRB approach to credit risk				
452 (a)	Permission for use of the IRB approach from the competent authority.	x		Page 37 (Scope of the IRB permission)
452 (b)	Explanation of:			
452 (b) (i)	Internal rating scales, mapped to external ratings;	x		Page 36 (Internal Ratings Scales)
452 (b) (ii)	Use of internal ratings for purposes other than capital requirement calculations;	x		Page 39 (Other application of IRB model outputs)
452 (b) (iii)	Management and recognition of credit risk mitigation;	x		Pages 33-35 (Credit risk mitigation)
452 (b) (iv)	Controls around ratings systems.	x		Page 38 (Internal development and monitoring of IRB models)
452 (c) (i)-(v)	Description of ratings processes for each IRB asset class, provided separately.	x		Page 37 (Scope of the IRB permission) and Page 38 (Internal development and monitoring of IRB models)
452 (d)	Exposure values by IRB exposure class, separately for Advanced and Foundation IRB.	x		Pages 49-50 (Table 23: Total and average net amount of exposures (CRB-B)). This is also shown in other tables throughout the document.
452 (e)-(f)	For each exposure class, disclosed separately by obligor grade: Total exposure, separating loans and undrawn exposures where applicable, and exposure-weighted average risk weight.	x		Pages 52-61 (Analysis of Credit Risk Exposures subject to the Foundation IRB approach including Tables 24-29 and Tables 31-33)
452 (g)	Actual specific risk adjustments for the period and explanation of changes.	x		Page 76 (Comparison of expected losses to Specific credit risk adjustments)
452 (h)	Commentary on drivers of losses in preceding period.	x		Pages 77-78 (Table 48: Regulatory expected losses and specific credit risk adjustments)
452 (i)	Estimates against actual losses for sufficient period, and historical analysis to help assess the performance of the rating system over a sufficient period.	x		Pages 39-48 (Model performance, including Table 15: Model performance and Tables 16-22: Back-testing of PD per portfolio for different asset classes)
452 (j)	For all IRB exposure classes:			
452 (j) (i)-(ii)	Where applicable, PD and LGD by each country where the bank operates.	x		Page 68 (Table 39: Exposures subject to the IRB approach analysed by geographical region)

Appendix 5: CRR mapping continued

CRR ref	High-level summary	Pillar 3	ARA	Compliance reference
Use of credit risk mitigation techniques				
453 (a)	Use of on and off-balance sheet netting.	x		Pages 33-35 (Credit risk mitigation)
453 (b)	How collateral valuation is managed.	x		Please note additional information with regards to balance sheet netting and derivatives is included in Counterparty Credit Risk section of Pillar 3 (Pages 90-100)
453 (c)	Description of types of collateral used by the institution.	x		
453 (d)	Main types of guarantor and credit derivative counterparty, creditworthiness.	x		
453 (e)	Market or credit risk concentrations within risk mitigation exposures.		x	Pages 116-117 (Credit Risk)
453 (f)	Standardised or Foundation IRB Approach, exposure value covered by eligible collateral.	x		Page 35 (Table 12: CRM Techniques – Overview (CR3))
453 (g)	Exposures covered by guarantees or credit derivatives.			
Use of the Advanced Measurement Approaches to Operational Risk				
454	Description of the use of insurance or other risk transfer mechanisms to mitigate operational risk.			Not applicable
Use of Internal Market Risk Models				
455 (a) (i)	Disclosure of the characteristics of the market risk models.	x		Page 102 (Key characteristics of market risk models)
455 (a) (ii)	Disclosure of the methodologies used to measure incremental default and migration risk.	x		Page 102 (Review of internal models)
455 (a) (iii)	Descriptions of stress tests applied to the portfolios.	x		Page 103 (Stress Testing)
455 (a) (iv)	Methodology for back-testing and validating the models.	x		Page 103 (Back testing of VaR models, including Table 73: Backtesting results (VaR models))
455 (b)	Scope of permission for use of the models.	x		Page 102 (Review of internal models)
455 (c)	Policies and processes to determine trading book classification, and to comply with prudential valuation requirements.	x		Page 104 (Valuation principles)
455 (d) (i)-(iii)	High/Low/Mean values over the year of VaR, SVaR and incremental risk charge.	x	x	Annual Report: Page 155 (Table 1.49: Trading portfolios: VaR (1-day 95 per cent confidence level)) Pillar 3: Page 105 (Table 75: IMA values for trading portfolios (MR3))
455 (e)	The elements of the own fund calculation.	x		Page 99 (Table 70: Market risk own funds requirements)
455 (f)	Weighted average liquidity horizons of portfolios covered by models.	x		Page 102 (Review of internal models)
455 (g)	Comparison of end-of-day VaR measures compared with one-day changes in the portfolio's value.	x		Page 104 (Comparison of VaR estimates to hypothetical and clean profit and loss)

Abbreviations

Abbreviation	Brief description
A	
ABCP	Asset-backed commercial paper
ABS	Asset-backed securities
AFS	Available-for-sale
AIRB	Advanced Internal Ratings-Based Approach
ALRB	Additional Leverage Ratio Buffer
AMA	Advanced Measurement Approach
AT1	Additional Tier 1 capital
B	
BCBS	Basel Committee on Banking Supervision
BEEL	Best estimate of expected losses
BRC	Board Risk Committee
C	
CCB	Capital Conservation Buffer
CCF	Credit conversion factor
CCLB	Countercyclical Leverage Buffer
CCP	Central counterparty
CCR	Counterparty credit risk
CCyB	Countercyclical Capital Buffer
CDS	Credit default swap
CET1	Common equity tier 1 capital
CLN	Credit linked notes
CP	Commercial paper
CRD IV	Capital Requirements Directive & Regulation
CRM	Credit risk mitigation
CRR	Capital Requirements Regulation
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
EEL	Excess expected loss
EL	Expected loss
EU	European Union
F	
FCCM	Financial Collateral Comprehensive Method
FII	Financial Institutions Interconnectedness
FIRB	Foundation Internal Ratings-Based Approach
Fitch	Fitch Ratings
FPC	Financial Policy Committee (UK)
FRTB	Fundamental review of the trading book (BCBS)
G	
GALCO	Group Asset and Liability Committee
GEC	Group Executive Committee
GRC	Group Risk Committee
Group	Lloyds Banking Group plc together with its subsidiary undertakings on a consolidated basis
G-SIB	Global Systemically Important Bank
H	
HPI	House price index
HQLA	High quality liquid assets
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
IRRBB	Interest rate risk in the banking book
IRC	Incremental risk charge
ISDA	International Swaps and Derivatives Association
L	
LCR	Liquidity coverage ratio
LGD	Loss given default
LIBOR	London Interbank Offer Rate
LTV	Loan-to-value
M	
MGC	Model Governance Committee
Moody's	Moody's Investors Service
MTM	Mark-to-market
O	
OTC	Over-the-counter
P	
PD	Probability of default
PFE	Potential future exposure
PIT	Point-in-time
PRA	Prudential Regulation Authority (UK)
PRR	Position risk requirement
PVA	Prudent valuation adjustment
Q	
QRRE	Qualifying revolving retail exposure

Abbreviations continued

R	
RBA	Ratings Based Approach
Retail IRB	Retail Internal Ratings Based Approach
RMBS	Residential mortgage-backed security
RNIV	Risks not in VaR

S	
STA	Standardised Approach
S&P	Standard and Poor's
SCRA	Specific credit risk adjustment
SE	Structured entity
SFTs	Securities financing transactions
SME	Small and medium-sized enterprise
SRB	Systemic risk buffer
SRT	Significant risk transfer

T	
TTC	Through-the-cycle
T1	Tier 1 capital
T2	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 Framework	The initial capital reforms and global liquidity standard introduced by the Basel Committee on Banking Supervision in 2010 that are being phased in through CRD IV. The final reforms under the Framework were published in December 2017, to be implemented by 2022.
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 seller in a financial transaction, such as a derivative contract or repurchase agreement. 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 guarantees	A guarantee which is backed by assets pledged to the bank to provide additional comfort around the value of protection offered by the guarantee.
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 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 conduit, as an asset-backed obligation (in such a case it is referred to as **Asset-Backed Commercial Paper**). Commercial paper is usually issued for periods from as little as a week up to nine months.
Commercial real estate	Commercial real estate includes office buildings, industrial properties, 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.
Countercyclical capital buffer	The countercyclical capital buffer is time-varying and 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.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial instruments and may include derivative contracts and repo contracts.
CRD 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 initial 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 phased in over time.
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 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.

Glossary continued

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 (CLN)	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 adjustment charge	Charges booked in the period for specific and general credit risk adjustments.
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 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.
Equity risk	The financial risk involved in holding equity in a particular investment.
Expected Loss (EL)	A regulatory measure under Internal Ratings Based approaches of the expected loss on a credit risk exposure over a 12 month time horizon. It is determined by multiplying the **Probability of Default** by the **Loss Given Default** by the **Exposure of Default.** The EL rates under the Supervisory Slotting Approach and Simple Risk Weight Method are set by the CRD IV rules.
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)	An estimate of the amount expected to be 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.
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.
Gross carrying values	The accounting value before any allowance/impairments.
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.

Glossary continued

Impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
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 addition to its Pillar 1 capital requirement to capture risks not covered or not fully covered under Pillar 1. This includes 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 can only apply the IMM if it has permission from the PRA to do so.
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 ISDA which is used as an umbrella contract for bilateral derivative contracts.
Leverage ratio	A capital 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 adjusted 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. The Group is subject to the UK Ratio Framework which excludes qualifying central bank claims from the leverage exposure measure and sets minimum requirements, including leverage ratio buffers.
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.
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.
Pillar 1	The first pillar of the Basel III framework sets out the minimum regulatory capital requirements for credit, operational and market risks.

Glossary continued

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 bank's 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)	An additional measure of counterparty credit risk over and above the current replacement cost of the derivative contract. It is defined as the maximum potential credit exposure of a derivative contract representing the additional amount by which the exposure could increase over the remaining life of the contract with a given level of confidence.
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.
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 notes issued by a securitisation.
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.

Glossary continued

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.
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 when 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.
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 mainly comprising certain subordinated debt securities that do not qualify as AT1 capital. Such securities must have an original term of at least 5 years and cannot normally be redeemed within their first 5 years.
Total Return Swap	A total return swap 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.
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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