Lloyds TSB Bank plc

Report and Accounts

2009

Member of Lloyds Banking Group

Contents

Directors' report 2

Directors 5

Principal risks and uncertainties 6

Independent auditors' report 9

Consolidated income statement 10

Statements of comprehensive income 11

Balance sheets 12

Statements of changes in equity 14

Cash flow statements 15

Notes to the accounts 16

Registered office:
25 Gresham Street, London EC2V 7HN.
Registered in England no 2065

Directors' report

Results
The consolidated income statement on page 10 shows a loss attributable to equity shareholders for the year ended 31 December 2009 of £2,797 million.

Principal activities
The Bank and its subsidiaries provide a wide range of banking and financial services through branches and offices in the UK and overseas.

Business review
The consolidated results of Lloyds TSB Bank plc (the Bank) together with its subsidiaries (the Group) are as follows:

The loss before tax of £4,378 million for the year ended 31 December 2009 compares to a profit before tax of £825 million for the year ended 31 December 2008. The decrease in profit arises principally as a result of the payment of a fee of £2,500 million to the UK Government as part of the agreement not to enter into the Government Asset Protection Scheme (the 'GAPS fee') and a payment of £3,000 million to its fellow banking subsidiary, Bank of Scotland plc to support its financial and reputational position and to facilitate the ongoing integration of the group's banking systems (the 'HBOS subvention payment') together with an increase in the impairment charge, which reflects the recent credit environment and current economic conditions. These adverse impacts have been partly offset by gains of £1,773 million arising on the redemption of subordinated debt and by the absence in 2009 of a charge in respect of market dislocation.

Net interest income declined by 32 per cent to £5,299 million as both interest income and interest expense fell in response to the historically low interest rate environment that has prevailed throughout the year. Declines in fee and commission income and expense reflect lower volumes of new business, in particular reduced payment protection insurance income. Net trading income, which includes the impact of changes in value of financial instruments held at fair value in the insurance businesses, increased by £16,469 million compared with the previous year; much of this is attributable to long-term policyholders and is offset by a movement in insurance claims (see below). Insurance premium income declined as a result of lower levels of new business but other operating income increased by £2,779 million; the year ended 31 December 2009 includes £1,773 million of gains arising on the repurchase of own debt and an £836 million improvement in the movement in value of in-force insurance business.

Overall, total income increased by £15,195 million to £22,189 million from £6,994 million in the year ended 31 December 2008.

Insurance claims increased by £12,489 million to a charge of £9,630 million in 2009 compared to a credit of £2,859 million in 2008, reflecting the substantial improvement in investment returns attributable to policyholders.

Operating expenses increased by £6,503 million to £12,523 million in 2009 compared to £6,020 million in 2008; however excluding the £2,500 million GAPS fee and the £3,000 million HBOS subvention payment, operating expenses were £1,003 million higher at £7,023 million reflecting costs of £635 million incurred in relation to the integration of the Lloyds TSB and HBOS businesses.

Impairment losses increased by £1,404 million to £4,416 million in the year ended 31 December 2009 from £3,012 million last year. The increase includes £1,664 million in respect of loans and advances to customers and reflects the substantial deterioration in the credit environment; partly offset by a reduction in the charge in respect of loans and advances to banks and other impairment provisions.

Total assets have increased by £136,789 million, largely reflecting the funding of fellow Lloyds Banking Group undertakings, principally HBOS. An increase in cash and balances at central banks of £31,081 million, as more funds are being placed with the Bank of England due to the attractive interest rate paid, has been more than offset by reductions in available-for-sale financial assets, as treasury bills held at the end of 2008 to provide liquidity have matured; external lending to customers, reflecting increased write-offs, deleveraging, and weak demand for credit; and in derivative assets.

Financial risk management objectives and policies
Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in note 51 on pages 81 to 101.

Directors' report

Group structure

Following a reorganisation of Lloyds Banking Group on 1 January 2010, the Bank acquired 100 per cent of the issued ordinary share capital of HBOS plc from Lloyds Banking Group plc; the consideration for this transfer was the issue of 21.4 million shares to Lloyds Banking Group plc for a total value of £21,394 million.

Directors

The names of the directors of the Bank are shown on page 5.

Six directors stood down from the Board during the year, as follows: Mr J P du Plessis (17 April), Mr Ewan Brown (5 June), Sir Victor Blank (15 September), Mr P N Green (23 October), Sir David Manning (2 November) and Ms C J McCall (31 December).

Mr T T Ryan, Mr Anthony Watson and Sir Winfried Bischoff joined the board on 1 March 2009, 2 April 2009 and 15 September 2009, respectively and Mr G R Moreno and Mr D L Roberts have been appointed directors from 1 March 2010.

Directors' interests

The directors are also directors of Lloyds Banking Group plc and their interests in the share and loan capital of Lloyds Banking Group plc and its subsidiaries are shown in the report and accounts of that company.

Directors' indemnities

The directors, including six former directors who left during the year, have entered into individual contracts of indemnity with Lloyds Banking Group plc which constituted 'qualifying third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' for the purposes of the Companies Act 2006. These contracts were in force during the whole of the financial year or from the date of appointment in respect of the three directors who joined the board in 2009. The contracts for existing directors remain in force and are available for inspection at the Bank's registered office.

Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the consolidated and parent company financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the parent company and the Group and of the profit or loss of the Group for that period. The directors consider that, in preparing the financial statements on pages 10 to 106, the Bank and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The directors have responsibility for ensuring that the Bank and the Group keep proper accounting records which disclose with reasonable accuracy the financial position of the Bank and the Group and which enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Bank and the Group and to prevent and detect fraud and other irregularities.

A copy of the financial statements is placed on our website www.lloydsbankinggroup.com. The directors are responsible for the maintenance and integrity of statutory and audited information in relation to the Bank on that website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Going concern

The going concern of the Bank and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Bank and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies as discussed in note 1 and additionally have considered projections for the Group's capital and funding position. Having considered these, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Employees

The Bank is committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief.

In the UK, the Bank belongs to the major employer groups campaigning for equality for the above groups of staff, including Employers' Forum on Disability, Employers' Forum on Age, Stonewall and the Race for Opportunity. Our involvement with these organisations enables us to identify and implement best practice for our staff.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group.

Policy and practice on payment of creditors

The Bank has signed up to the 'Prompt Payment Code' published by the Department for Business Innovation and Skills ('BIS'), regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the BIS Publications Orderline 0845 015 0010, quoting ref URN 04/606. Alternatively, visit www.payontime.co.uk for details.

The Bank's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Bank to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is 29. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2009 bears to the aggregate of the amounts invoiced by suppliers during the year.

Directors' responsibility statement

Each of the current directors, whose names are shown on page 5 of this annual report, confirms that, to the best of his or her knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and Group; and
- the management report contained in the business review includes a fair review of the development and performance of the business and the position of the Bank and Group, together with a description of the principal risks and uncertainties they face.

Auditors and audit information

Each person who is a director at the date of approval of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Bank's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

On behalf of the board

Harry F Baines
Company Secretary
25 February 2010
Company number 2065

Directors

Sir Winfried Bischoff *Chairman*

J E Daniels *Chief Executive*

T J W Tookey *Finance Director*

Dr W C G Berndt

Sir Julian Horn-Smith

A G Kane

Lord Leitch

G R Moreno
(from 1 March 2010)

D L Roberts
(from 1 March 2010)

T T Ryan, Jr

M A Scicluna

G T Tate

A Watson CBE

H A Weir CBE

Principal risks and uncertainties

At present the most significant risks faced by the Bank are:

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

Features: Arising from the Bank's lending activities in its retail, wholesale and wealth and international operations. Over the last two years the deteriorating economic outlook, both in the UK and overseas, brought about by the banking crisis has impacted the financial services industry resulting in further high profile losses and writedowns. The Bank is impacted by the economic downturn and a further worsening of the business environment could adversely impact earnings.

This poses a major risk to the Bank and its lending to:

- Retail customers, where reducing affordability and/or asset values arising from a combination of house price falls, continuing high, or increasing levels of unemployment, consumer over-indebtedness, and rising interest rates impact both secured and unsecured retail exposures.
- Wholesale customers, where companies are facing increasingly difficult business conditions, resulting in corporate default levels rising and leading to increases in corporate impairment. The Bank has high levels of exposure in the UK and some internationally. There are particular concentrations to financial institutions and real estate.

The Bank follows a through the economic cycle, relationship based, business model with risk management processes, appetites and experienced staff in place.

Legal and regulatory
Definition: The risk of regulatory action leading to fine and/or public censure and/or successful legal action being taken against the Bank as a result of failure to meet one or more legal and/or regulatory requirements either in the UK or overseas.

Features: The industry is currently subject to a wide range of international and UK consultations on proposals to change the regulatory requirements. For example the Basel Committee on Banking Supervision has issued proposals with respect to capital and liquidity requirements for banks ('Strengthening the resilience of the banking sector' and 'International framework for liquidity risk measurement, standards and monitoring') and draft proposals have also been issued for new capital requirements for insurers (Solvency II). In the UK we have seen the Turner review and more recently, proposals have been issued for governance, recovery and resolution ('Living Wills') arrangements and also, potentially conduct of business requirements, which could have significant implications for past business as well as future product offerings for customers. There is a high level of uncertainty both as to the financial outcome in terms of specific requirements and the speed of implementation in the UK and internationally.

The Bank is currently assessing the impacts of these regulatory proposals, and will participate in the consultation and calibration processes to be undertaken by the various regulatory bodies during 2010. The Bank currently meets and exceeds its regulatory capital requirements and expects to continue to do so. However, the FSA could impose more stringent capital and liquidity requirements, and/or introduce new ratios and/or change the manner in which it applies existing requirements to recapitalised banks. Any one or combination of these events could result in the Bank being forced to raise further capital or to divest assets.

The Bank has made good preparations for the FSA's new liquidity regime (ILAS) and is ready to meet the reporting implications later in the year.

The Bank's policy is to maintain high levels of compliance with regulatory requirements and it will organise its business to maintain this level of compliance as the requirements become clearer, being mindful of maintaining an appropriate balance between risk and reward.

Liquidity and funding
Definition: Liquidity risk is defined as the risk that the Bank has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Funding risk is defined as the risk that the Bank does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.

Principal risks and uncertainties

Features: Arising in the banking business and reflecting the risk that the Bank is unable to attract and retain either retail, wholesale or corporate deposits or issue debt securities. Like all major banks, the Bank is dependent on confidence in the short and longer term wholesale funding markets; should the Bank, due to exceptional circumstances, be unable to continue to source sustainable funding and provide liquidity when necessary, it could impact its ability to fund its financial obligations.

The key dependencies for successfully funding the Bank's balance sheet include the continued functioning of the money and capital markets at their current levels; successful right sizing of the Bank's balance sheet; the continuation of HM Treasury facilities in accordance with the terms agreed; limited further deterioration in the UK's and the Bank's credit rating and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or UK Government support schemes. A return to the extreme market conditions of 2008 would place a strain on the Bank's ability to meet its financial commitments.

Liquidity risk is managed within a board approved framework using a range of metrics to monitor the Bank's profile against its stated appetite and potential market conditions.

Customer treatment
Definition: The risk of regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment.

Features: Customer treatment and how the Bank manages its customer relationships affects all aspects of the Bank's operations and is closely aligned with achievement of the Bank's strategic aim – to create deep long lasting relationships with its customers. There is currently a high level of scrutiny regarding the treatment of customers by financial institutions from the press, politicians and regulatory bodies.

The Office of Fair Trading's (OFT) investigation and legal test case in respect of unarranged overdraft charges on personal current accounts concluded in 2009. The OFT is however continuing to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. The OFT aims to report on progress in respect of further changes it believes are required to make the market work in the best interest of bank customers by the end of March 2010.

The Bank regularly reviews its product range to ensure that it meets regulatory requirements and is competitive in the market place. Treating Customers Fairly remains the key principle underpinning the FSA's consumer protection objective. An additional challenge for the Bank is ensuring the fair treatment of customers during integration of the two heritage businesses. As a result the customer relationship management risks posed by integration are carefully considered through the integration governance process in place. If the Bank is unable to demonstrate the fair treatment of its customers there is the risk of increased complaints from customers, the potential for regulatory action (which could include reviews of past business and/or the payment of fines and compensation) and adverse media coverage (leading to reputational damage in the marketplace). The Bank has policies, procedures and governance arrangements in place to facilitate the fair treatment of customers.

People
Definition: The risk of reduction in earnings and/or value, through financial or reputational loss, from failure to retain, train, reward, recruit and incentivise appropriately skilled staff, inappropriate staff behaviour or industrial action.

Features: The delivery of the Bank's objectives is underpinned by the ability to attract, retain and develop the best talent in the industry. The challenges to the people agenda have never been greater with increased regulatory and public interest in remuneration practices, the effects of the Government shareholding and the impacts of integration. The Bank welcomes the regulation of remuneration provided there is an international consensus and will comply with the FSA Code. The Bank has managed the initial stages of integration, working to establish control by defining and implementing the new organisational structures and continues to manage the relationship with colleagues during this period of change. The Bank has policies, procedures and governance arrangements in place to ensure the effective management of people risk as the Bank integrates and grows its business. Proposals to harmonise employee terms and conditions have been published and the Bank is consulting with the various representative unions. The Bank actively manages its relationships with unions, but is aware of the danger of

industrial action, business disruption and reputational impact arising from union behaviour and communications. People risk is closely monitored as a key risk indicator, as well as being subject to oversight by the board.

Integration

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

Features: The integration of the two legacy organisations presents one of the largest integration challenges that has been seen in the UK financial services industry. There is a risk that the Bank may fail to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from the acquisition of HBOS plc by Lloyds Banking Group plc, or may incur unanticipated costs and losses associated as a result. As a consequence, the Bank's results may suffer as a result of operational, financial management and other integration risks. The risk of failure to deliver synergy benefits or to meet publicly stated targets could potentially result in a loss of shareholder or market confidence with negative perceptions of the Bank's integration strategy. As the Bank goes through the integration process there is a danger of losing key staff potentially impacting upon integration plans.

An integration executive board has been created to oversee the integration process. The Bank is now one year into the integration programme and has a fully developed and functioning governance framework to manage these risks, with clear understanding of the dependencies and phased deliverables through to 2012. The programme is ahead of plan.

Independent auditors' report

To the members of Lloyds TSB Bank plc

We have audited the group and parent company financial statements of Lloyds TSB Bank plc for the year ended 31 December 2009 which comprise the consolidated and parent company balance sheets, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and parent company cash flow statements, the consolidated and parent company statements of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2009 and of the group's profit and group's and parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Ian Rankin (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
25 February 2010

Consolidated income statement

for the year ended 31 December 2009

	Note	2009 £ million	2008 £ million
Interest and similar income		**11,575**	17,569
Interest and similar expense		**(6,276)**	(9,797)
Net interest income	4	**5,299**	7,772
Fee and commission income		**2,821**	3,231
Fee and commission expense		**(680)**	(694)
Net fee and commission income	5	**2,141**	2,537
Net trading income	6	**7,214**	(9,255)
Insurance premium income	7	**4,228**	5,412
Other operating income	8	**3,307**	528
Other income		**16,890**	(778)
Total income		**22,189**	6,994
Insurance claims	9	**(9,630)**	2,859
Total income, net of insurance claims		**12,559**	9,853
Subvention payment		**(3,000)**	–
Government Asset Protection Scheme fee		**(2,500)**	–
Other operating expenses		**(7,023)**	(6,020)
Total operating expenses	10	**(12,523)**	(6,020)
Trading surplus		**36**	3,833
Impairment	11	**(4,416)**	(3,012)
Share of results of joint ventures and associates		**2**	4
Profit (loss) before tax		**(4,378)**	825
Taxation	12	**1,605**	19
Profit (loss) for the year		**(2,773)**	844
Profit attributable to minority interests		**24**	26
Profit (loss) attributable to equity shareholders		**(2,797)**	818
Profit (loss) for the year		**(2,773)**	844

The accompanying notes are an integral part of the financial statements.

Statements of comprehensive income

for the year ended 31 December 2009

The Group

	2009 £ million	2008 £ million
Profit (loss) for the year	**(2,773)**	844
Other comprehensive income:		
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax:		
Change in fair value	**1,202**	(2,031)
Transferred to income statement in respect of disposals	**(3)**	(19)
Transferred to income statement in respect of impairment	**38**	102
Other transfers to income statement	**(21)**	(66)
	1,216	(2,014)
Movement in cash flow hedging reserve, net of tax:		
Effective portion of changes in fair value taken to other comprehensive income	**(3)**	(24)
Net gains transferred to the income statement	**(12)**	12
	(15)	(12)
Currency translation differences, net of tax	**131**	(359)
Other comprehensive income for the year, net of tax	**1,332**	(2,385)
Total comprehensive income for the year	**(1,441)**	(1,541)
Total comprehensive income attributable to minority interests	**5**	54
Total comprehensive income attributable to equity shareholders	**(1,446)**	(1,595)
Total comprehensive income for the year	**(1,441)**	(1,541)

The Bank

	2009 £ million	2008 £ million
Loss for the year	**(1,909)**	(418)
Other comprehensive income:		
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax:		
Change in fair value	**(21)**	(244)
Transferred to income statement in respect of disposals	**(3)**	(19)
Transferred to income statement in respect of impairment	**11**	102
Other transfers to income statement	**(42)**	(66)
	(55)	(227)
Movement in cash flow hedges, net of tax:		
Effective portion of changes in fair value taken to other comprehensive income	**(3)**	(24)
Net gains transferred to the income statement	**(12)**	12
	(15)	(12)
Currency translation differences	**(11)**	34
Other comprehensive income for the year, net of tax	**(81)**	(205)
Total comprehensive income for the year	**(1,990)**	(623)

Balance sheets

at 31 December 2009

	Note	The Group 2009 £ million	The Group 2008 £ million	The Bank 2009 £ million	The Bank 2008 £ million
Assets					
Cash and balances at central banks		**36,089**	5,008	**35,964**	4,890
Items in the course of collection from banks		**1,045**	946	**1,004**	909
Trading and other financial assets at fair value through profit or loss	*13*	**48,894**	45,115	**2,633**	3,679
Derivative financial instruments	*14*	**18,797**	28,884	**17,937**	26,704
Loans and receivables:					
Loans and advances to customers	*16*	**245,226**	240,344	**253,111**	249,363
Loans and advances to banks	*15*	**175,554**	38,733	**176,556**	36,968
Debt securities	*19*	**2,636**	4,416	**2,830**	3,863
		423,416	283,493	**432,497**	290,194
Available-for-sale financial assets	*21*	**26,089**	55,707	**13,514**	58,444
Investment properties	*22*	**2,340**	2,631	**–**	–
Investments in joint ventures and associates		**56**	55	**61**	61
Goodwill	*23*	**2,016**	2,256	**–**	–
Value of in-force business	*24*	**2,403**	1,893	**–**	–
Other intangible assets	*25*	**205**	197	**111**	100
Tangible fixed assets	*26*	**4,125**	2,965	**1,374**	1,333
Current tax recoverable		**85**	440	**886**	702
Deferred tax assets	*39*	**2,438**	837	**2,672**	1,161
Investment in subsidiary undertakings	*27*	**–**	–	**15,960**	15,992
Other assets	*28*	**4,982**	5,764	**816**	2,492
Total assets		**572,980**	436,191	**525,429**	406,661

The accompanying notes are an integral part of the financial statements.

The directors approved the financial statements on 25 February 2010.

Sir Winfried Bischoff
Chairman

J Eric Daniels
Chief Executive

Tim J W Tookey
Finance Director

Balance sheets

at 31 December 2009

	Note	The Group 2009 £ million	The Group 2008 £ million	The Bank 2009 £ million	The Bank 2008 £ million
Equity and liabilities					
Liabilities					
Deposits from banks	29	**139,557**	66,514	**160,428**	80,529
Customer deposits	30	**193,045**	172,364	**201,053**	184,041
Items in course of transmission to banks		**542**	508	**492**	467
Trading and other financial liabilities at fair value through profit or loss	31	**6,362**	6,754	**6,362**	6,754
Derivative financial instruments	14	**16,733**	28,189	**16,829**	29,730
Debt securities in issue	32	**120,719**	73,066	**109,870**	74,559
Liabilities arising from insurance contracts and participating investment contracts	33	**36,960**	33,827	**–**	–
Liabilities arising from non-participating investment contracts	35	**15,734**	14,243	**–**	–
Unallocated surplus within insurance businesses	36	**310**	270	**–**	–
Other liabilities	37	**12,263**	11,494	**3,437**	4,955
Retirement benefit obligations	38	**474**	1,771	**131**	1,354
Current tax liabilities		**22**	–	**15**	–
Other provisions	40	**547**	230	**533**	206
Subordinated liabilities	41	**15,999**	17,389	**15,456**	16,853
Total liabilities		**559,267**	426,619	**514,606**	399,448
Equity					
Share capital	42	**1,547**	1,542	**1,547**	1,542
Share premium account	43	**8,555**	2,960	**8,555**	2,960
Other reserves	44	**(1,473)**	(2,824)	**(330)**	(249)
Retained profits	45	**4,791**	7,588	**1,051**	2,960
Shareholders' equity		**13,420**	9,266	**10,823**	7,213
Minority interests		**293**	306	**–**	–
Total equity		**13,713**	9,572	**10,823**	7,213
Total equity and liabilities		**572,980**	436,191	**525,429**	406,661

The accompanying notes are an integral part of the financial statements.

Statements of changes in equity

The Group

	Attributable to equity shareholders				
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Minority interests £ million	Total £ million
Balance at 1 January 2008	4,502	(411)	9,064	284	13,439
Total comprehensive income	–	(2,413)	818	54	(1,541)
Dividends	–	–	(2,294)	(29)	(2,323)
Repayment of capital to minority shareholders	–	–	–	(3)	(3)
Balance at 31 December 2008	**4,502**	**(2,824)**	**7,588**	**306**	**9,572**
Total comprehensive income	**–**	**1,351**	**(2,797)**	**5**	**(1,441)**
Capital injection	**5,600**	**–**	**–**	**–**	**5,600**
Dividends	**–**	**–**	**–**	**(18)**	**(18)**
Balance at 31 December 2009	**10,102**	**(1,473)**	**4,791**	**293**	**13,713**

The Bank

	Attributable to equity shareholders			
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million
Balance at 1 January 2008	4,502	(44)	5,672	10,130
Total comprehensive income	–	(205)	(418)	(623)
Dividends	–	–	(2,294)	(2,294)
Balance at 31 December 2008	**4,502**	**(249)**	**2,960**	**7,213**
Total comprehensive income	**–**	**(81)**	**(1,909)**	**(1,990)**
Capital injection	**5,600**	**–**	**–**	**5,600**
Balance at 31 December 2009	**10,102**	**(330)**	**1,051**	**10,823**

Cash flow statements

for the year ended 31 December 2009

	Note	The Group 2009 £ million	The Group 2008 £ million	The Bank 2009 £ million	The Bank 2008 £ million
Profit (loss) before tax		**(4,378)**	825	**(3,570)**	(857)
Adjustments for:					
Change in operating assets	*53a*	**(142,905)**	(42,842)	**(143,910)**	(62,304)
Change in operating liabilities	*53b*	**132,435**	82,449	**136,658**	110,400
Non-cash and other items	*53c*	**4,683**	(4,525)	**(447)**	4,473
Tax received (paid)		**83**	(887)	**16**	(620)
Net cash (used in) provided by operating activities		**(10,082)**	35,020	**(11,253)**	51,092
Cash flows from investing activities:					
Purchase of available-for-sale financial assets		**(445,140)**	(144,680)	**(420,748)**	(153,091)
Proceeds from sale and maturity of available-for-sale financial assets		**474,173**	110,470	**446,249**	99,811
Purchase of fixed assets		**(1,310)**	(1,436)	**(435)**	(610)
Proceeds from sale of fixed assets		**491**	579	**19**	30
Additional capital injections to subsidiaries		**–**	–	**(1)**	(50)
Capital repayments by subsidiaries		**–**	–	**–**	805
Acquisition of businesses, net of cash acquired	*53f*	**(35)**	(19)	**–**	(817)
Disposal of businesses, net of cash disposed	*53g*	**–**	–	**33**	187
Net cash provided by (used in) investing activities		**28,179**	(35,086)	**25,117**	(53,735)
Cash flows from financing activities:					
Dividends paid to equity shareholders		**–**	(2,294)	**–**	(2,294)
Dividends paid to minority interests	*53e*	**(18)**	(29)	**–**	–
Interest paid on subordinated liabilities		**(968)**	(819)	**(939)**	(745)
Proceeds from issue of subordinated liabilities	*53e*	**3,187**	3,021	**3,187**	3,021
Proceeds from issue of ordinary shares		**5,600**	–	**5,600**	–
Repayment of subordinated liabilities	*53e*	**(1,842)**	(381)	**(1,842)**	(381)
Repayment of capital to minority shareholders	*53e*	**–**	(3)	**–**	–
Net cash provided by (used in) financing activities		**5,959**	(505)	**6,006**	(399)
Effect of exchange rate changes on cash and cash equivalents		**(210)**	1,440	**(87)**	1,439
Change in cash and cash equivalents		**23,846**	869	**19,783**	(1,603)
Cash and cash equivalents at beginning of year		**32,760**	31,891	**22,424**	24,027
Cash and cash equivalents at end of year	*53d*	**56,606**	32,760	**42,207**	22,424

The accompanying notes are an integral part of the financial statements.

Notes to the accounts

1 Basis of preparation

The global upheaval in the financial markets that occurred during 2008 has abated during the latter part of 2009. The steps taken in 2008 by HM Treasury through the introduction of the UK Government's Credit Guarantee Scheme for senior funding and the Bank of England through various facilities have together continued to provide assurance of liquidity support to the banking markets. Notwithstanding the improvement in market liquidity during 2009, the Bank continues to be reliant upon these facilities in order to maintain its wholesale funding position. The Bank is dependent upon its parent, Lloyds Banking Group plc, to provide capital.

During the year, Lloyds Banking Group plc has taken steps to strengthen the Bank's capital position in order to provide a buffer against further shocks arising from the economic environment.

Based upon projections prepared by management, which take into account the funding needs of the Lloyds Banking Group as a whole and which assume that the Government sponsored facilities will continue to be available, the directors are satisfied that the Bank has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Bank have been prepared on a going-concern basis.

2 Accounting policies

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 Financial Instruments: Recognition and Measurement relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

The following relevant IFRS pronouncements have been adopted in these financial statements:

(i) *IAS 1 (revised), 'Presentation of financial statements'.* The revised standard prohibits the presentation of items of income and expense (that is 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity are required to be shown in a performance statement. Entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). The Group has elected to present two statements: an income statement and a statement of comprehensive income. The financial statements have been prepared under the revised disclosure requirements; the application of this revised standard, which affects presentation only, has not had any impact for amounts recognised in these financial statements.

(ii) *Amendments to IFRS 7 'Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments'*. The amendment requires enhanced disclosures about fair value measurement and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy. As the amendments only result in additional disclosures, the amendments have not had any impact for amounts recognised in these financial statements.

(iii) *IFRS 8 'Operating Segments'.* The new standard replaces IAS 14 'Segment Reporting' and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. The chief operating decision maker has been identifed as the Group Executive Committee (GEC). The Group is managed on an entity basis and not by segment, and the GEC does not assess performance and allocate resources across any segments, accordingly no segmental information is provided. A brief overview of its sources of income is provided in the Financial review.

The ultimate parent undertaking, Lloyds Banking Group plc, produces consolided accounts which set out the basis of the segments through which it manages performance and allocates resources across the consolidated Group.

The application of the following IFRS pronouncements which all became effective in 2009 has had no material impact on these financial statements:

- Amendments to IFRIC 9 *Reassessment of Embedded Derivatives* and IAS 39 *Financial Instruments: Recognition and Measurement*. This amendment clarifies that a reassessment of embedded derivatives is required whenever a financial asset has been reclassified out of the fair value through profit or loss category.
- IFRIC 13 *Customer Loyalty Programmes*. This interpretation addresses accounting by entities who grant customer loyalty award credits to customers as part of sales transactions and which can be redeemed in the future for free or discounted goods or services. The majority of customer loyalty award schemes are operated by third parties.
- IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*. This interpretation provides guidance on accounting for hedges of net investments in foreign operations in an entity's consolidated financial statements.
- IAS 23 *Borrowing Costs*. This revised standard requires interest and other costs incurred in connection with the borrowing of funds to be recognised as an expense excepting that those which are directly attributable to the acquisition, construction or production of assets that take a substantial period of time to get ready for their intended use or sale must be capitalised as part of the cost of those assets.
- Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation*. The amendments require some puttable financial instruments (being those which give the holder the right to put the instrument back to the issuer for cash or another financial asset) and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.
- *Improvements to IFRSs* (issued May 2008). Sets out minor amendments to IFRS standards as part of annual improvements process. Most amendments clarified existing practice.
- Amendment to IAS 27 *Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*. This amendment removes the definition of the cost method and requires the presentation of dividends as income in the separate financial statements of the investor.

2 Accounting policies (continued)

The application of these new interpretations has not had any impact for amounts recognised in these financial statements.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2009 and which have not been applied in preparing these financial statements are given in note 54.

The accounting policies are set out below.

a Consolidation
The assets, liabilities and results of Group undertakings (including special purpose entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include subsidiaries, associates and joint ventures.

(1) *Subsidiaries*
Subsidiaries include entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Details of the principal subsidiaries are given in note 8 of the notes to the parent company's financial statements.

Investment vehicles, such as Open Ended Investment Companies (OEICs), where the Group has control, typically through acting as fund manager and the life funds having a beneficial interest greater than 50 per cent, are consolidated. The minority unitholders' interest is reported in other liabilities.

Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

(2) *Joint ventures and associates*
Joint ventures are entities over which the Group has joint control under a contractual arrangement with other parties. Associates are entities over which the Group has significant influence, but not control or joint control, over the financial and operating policies. Significant influence is the power to participate in the financial and operating policy decisions of the entity and is normally achieved through holding between 20 per cent and 50 per cent of the voting share capital of the entity.

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated at initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Group's share of the post-acquisition results of the joint venture or associate based on audited accounts which are coterminous with the Group or made up to a date which is not more than three months before the Group's reporting date. The share of any losses is restricted to a level that reflects an obligation to fund such losses.

b Goodwill
Goodwill arises on business combinations, including the acquisition of subsidiaries, and on the acquisition of interests in joint ventures and associates, and represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired. Where the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities of the acquired entity is greater than the cost of acquisition, the excess is recognised immediately in the income statement.

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. Goodwill arising on acquisitions of associates and joint ventures is included in the Group's investment in joint ventures and associates. At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal except where it has been written off directly to reserves in the past.

c Other intangible assets
Other intangible assets comprise capitalised software enhancements and customer related intangibles. Intangible assets which have been determined to have a finite useful life are amortised on a straight line basis over their estimated useful life as follows:

Capitalised software enhancements	up to 5 years
Customer-related intangibles	up to 10 years

Intangible assets with finite useful lives are reviewed at each reporting date to assess whether there is any indication that they are impaired. If any such indication exists the recoverable amount of the asset is determined and in the event that the asset's carrying amount is greater than its recoverable amount, it is written down immediately. Certain brands have been determined to have an indefinite useful life and are not amortised. Such intangible assets are reassessed annually to reconfirm that an indefinite useful life remains appropriate. In the event that an indefinite life is inappropriate a finite life is determined and an impairment review is performed on the asset.

d Revenue recognition
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability by estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Group including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has

2 Accounting policies (continued)

been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see h).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan once drawn. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to life insurance and general insurance business are detailed below (see o).

e Financial assets and liabilities
On initial recognition, financial assets are classified into fair value through profit or loss, available-for-sale financial assets or loans and receivables. Financial liabilities are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value. Purchases and sales of securities and other financial assets and liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

(1) *Financial instruments at fair value through profit or loss*
Financial instruments are classified at fair value through profit or loss where they are trading securities or where they are designated at fair value through profit or loss by management. Derivatives are carried at fair value (see f).

Trading securities are debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains. Such securities are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur. Financial assets and liabilities are designated at fair value through profit or loss on acquisition in the following circumstances:

– it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on different bases. The main type of financial assets designated by the Group at fair value through profit or loss are assets backing insurance contracts and investment contracts issued by the Group's life insurance businesses. Fair value designation allows changes in the fair value of these assets to be recorded in the income statement along with the changes in the value of the associated liabilities, thereby significantly reducing the measurement inconsistency had the assets been classified as available-for-sale financial assets.

– the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, with management information also prepared on this basis. As noted in accounting policy 2(a)(2), certain of the Group's investments are managed as venture capital investments and evaluated on the basis of their fair value and these assets are designated at fair value through profit or loss.

– Where the assets and liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Refer to note 3 (Critical accounting estimates and judgements: Valuation of financial instruments) and note 50 (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

The Group is permitted to reclassify, at fair value at the date of transfer, non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the trading category if they are no longer held for the purpose of being sold or repurchased in the near term, as follows:

– if the financial assets would have met the definition of loans and receivables (but for the fact that they had to be classified as held for trading at initial recognition), they may be reclassified into loans and receivables where the Group has the intention and ability to hold the assets for the foreseeable future or until maturity;

– if the financial assets would not have met the definition of loans and receivables, they may be reclassified out of the held for trading category into available-for-sale financial assets in 'rare circumstances'.

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

The Group is permitted to transfer, at fair value at the date of transfer, a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale)

2 Accounting policies (continued)

and where there is both the intention and ability to hold that financial asset for the foreseeable future. For assets transferred, gains or losses recognised in equity in respect of these assets as at the date of transfer are amortised to profit or loss over the remaining life of the asset using the effective interest method.

(3) *Loans and receivables*
Loans and receivables include loans and advances to banks and customers and eligible assets including those transferred into this category out of the fair value through profit or loss or available-for-sale financial assets categories. Loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs or, for eligible assets transferred into this category their fair value at the date of transfer. Financial assets classified as loans and receivables are accounted for at amortised cost using the effective interest method (see d) less provision for impairment (see h).

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. These loans and advances to customers continue to be recognised by the Group, together with a corresponding liability for the funding.

(4) *Borrowings*
Borrowings (which include deposits from banks, customer deposits, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

An exchange of financial liabilities on substantially different terms in accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The difference between the carrying amount of a financial liability extinguished and the new financial liability is recognised in profit or loss together with any related costs or fees incurred.

When a financial liability is exchanged for an equity instrument, the new equity instrument is recognised at fair value and any difference between the original carrying value of the liability and the fair value of the new equity is recognised in the profit or loss together with any related costs or fees incurred.

(5) *Sale and repurchase agreements*
Securities sold subject to repurchase agreements ('repos') continue to be recognised on the balance sheet where substantially all of the risks and rewards are retained. Funds received under these arrangements are included in deposits from banks, customer deposits, or trading liabilities. Conversely, securities purchased under agreements to resell ('reverse repos'), where the Group does not acquire substantially all of the risks and rewards of ownership, are recorded as loans and receivables or trading securities. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Securities lent to counterparties are retained in the financial statements. Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability.

(6) *Derecognition of financial assets and liabilities*
Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either:

– substantially all of the risks and rewards of ownership have been transferred; or

– the Group has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation is discharged), cancelled or expire.

f Derivative financial instruments and hedge accounting
All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and option pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 3 (Critical accounting estimates and judgements: Valuation of financial instruments) and note 50 (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. In accordance with IFRS 4 *Insurance Contracts*, a policyholder's option to surrender an insurance contract for a fixed amount is not treated as an embedded derivative.

The method of recognising the movements in the fair value of the derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of the same. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item and the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship is tested both at inception and throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

The Group designates certain derivatives as either: (1) hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges); (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges); or (3) hedges of net investments in foreign operations (net investment hedges). These are accounted for as follows:

(1) *Fair value hedges*
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk; this also applies if the hedged asset is classified as an available-for-sale financial asset. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the

2 Accounting policies (continued)

income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity.

(2) *Cash flow hedges*
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income in the cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(3) *Net investment hedges*
Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of. The hedging instrument in net investments hedges may include non-derivative liabilities as well as derivative financial instruments.

g Offset
Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

h Impairment of financial assets
(1) *Assets accounted for at amortised cost*
At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition and prior to the balance sheet date, there is objective evidence that a financial asset or group of financial assets has become impaired.

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

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

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

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

– Breach of loan covenants or conditions; and

– Initiation of bankruptcy or individual voluntary arrangement proceedings.

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

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

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

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

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

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

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

Equity securities acquired in exchange for loans in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of equity securities. Where control is obtained over an entity as a result of the transaction, the entity is consolidated; where the Group has significant influence over an entity as

2 Accounting policies (continued)

a result of the transaction, the investment is accounted for by the equity method of accounting (see a). Any subsequent impairment of the assets or business acquired is treated as an impairment of the relevant asset or business and not as an impairment of the original instrument.

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

i Investment property
Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital appreciation or both. The Group's investment property primarily relates to property held for long-term rental yields and capital appreciation within the life insurance funds. Investment property is carried in the balance sheet at fair value, being the open market value as determined in accordance with the guidance published by the Royal Institution of Chartered Surveyors. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair value are recognised in the income statement as net trading income for investment property within the life insurance funds and as other operating income for other investment property.

j Tangible fixed assets
Tangible fixed assets are included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

- Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease
- Leasehold improvements: shorter of 10 years or, if lease renewal is not likely, the remaining period of the lease

Equipment:

- Fixtures and furnishings: 10-20 years
- Other equipment and motor vehicles: 2-8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

k Leases
(1) *As lessee*
The leases entered into by the Group are primarily operating leases. Operating lease rentals payable are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

(2) *As lessor*
Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee but not necessarily legal title. All other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable, net of provisions, within loans and advances to banks and customers. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance lease income. Finance lease income is recognised in interest income over the term of the lease using the net investment method (before tax) so as to give a constant rate of return on the net investment in the leases. Unguaranteed residual values are reviewed regularly to identify any impairment.

Operating lease assets are included within tangible fixed assets at cost and depreciated over their estimated useful lives, which equates to the lives of the leases, after taking into account anticipated residual values. Operating lease rental income is recognised on a straight line basis over the life of the lease.

The Group evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease which is then accounted for separately.

l Pensions and other post-retirement benefits
The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

2 Accounting policies (continued)

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Group's income statement charge includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities ('the corridor approach'). In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives. Past service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date adjusted for any cumulative unrecognised actuarial gains or losses. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The Group recognises the effect of material changes to the terms of its defined benefit pension plans which reduce future benefits as curtailments; gains and losses are recognised in the income statement when the curtailments occur.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

m Share-based compensation
Lloyds Banking Group operates a number of equity-settled, share-based compensation plans in respect of services received from certain of its employees. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period, together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement over any remaining vesting period.

n Taxation
Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term insurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to gains and losses on the fair value re-measurement of available-for-sale investments and cash flow hedges, where the gains and losses are recognised in other comprehensive income, is also recognised in other comprehensive income such deferred tax is subsequently transferred to the income statement together with the deferred gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

o Insurance
The Group undertakes both life insurance and general insurance business.

Products sold by the life insurance business are classified into three categories:

Insurance contracts – these contracts transfer significant insurance risk and may also transfer financial risk. The Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. These contracts may or may not include discretionary participation features.

Investment contracts containing a discretionary participation feature ('participating investment contracts') – these contracts do not transfer significant insurance risk, but contain a contractual right which entitle the holder to receive, in addition to the guaranteed benefits, further additional discretionary benefits or bonuses that are likely to be a significant proportion of the total contractual benefits and the amount and timing of which is at the discretion of the Group and based upon the performance of specified assets.

Non-participating investment contracts – these contracts do not transfer significant insurance risk or contain a discretionary participation feature.

2 Accounting policies (continued)

The general insurance business issues only insurance contracts.

(1) *Life insurance business*

(I) ***Accounting for insurance and participating investment contracts***

Premiums and claims

Premiums received in respect of insurance and participating investment contracts are recognised as revenue when due except for unit-linked contracts on which premiums are recognised as revenue when received. Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified.

Liabilities

– *Insurance or participating investment contracts in the Group's with-profit funds*

Liabilities of the Group's with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in unallocated surplus (see below). Further details on the realistic capital regime are given in note 33. Change in the value of these liabilities are recognised through insurance claims.

– *Insurance and participating investment contracts which are not unit-linked or in the Group's with-profit funds*

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life insurance and annuity benefits where future mortality is uncertain.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

Changes in the value of these liabilities are recognised in the income statement through insurance claims.

– *Insurance and participating investment contracts which are unit-linked*

Liabilities for unit-linked insurance contracts and participating investment contracts are stated at the bid value of units plus, an additional allowance where appropriate (such as for any excess of future expenses over charges). The liability is increased or reduced by the change in the unit prices and is reduced by policy administration fees, mortality and surrender charges and any withdrawals. Changes in the value of the liability are recognised in the income statement through insurance claims. Benefit claims in excess of the account balances incurred in the period are also charged through insurance claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges.

Unallocated surplus

Any amounts in the with-profit funds not yet determined as being due to policyholders or shareholders are recognised as an unallocated surplus which is shown separately from liabilities arising from insurance contracts and participating investment contracts.

(II) ***Accounting for non-participating investment contracts***

The Group's non-participating investment contracts are primarily unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable. Investment income allocated to non-participating investment contracts is included in insurance claims.

Deposits and withdrawals are not accounted for through the income statement but are accounted for directly in the balance sheet as adjustments to the non-participating investment contract liability.

The Group receives investment management fees in the form of an initial adjustment or charge to the amount invested. These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts, in line with the provision of investment management services.

Costs which are directly attributable and incremental to securing new non-participating investment contracts are deferred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately through fee and commission expense in the income statement. All other costs are recognised as expenses when incurred.

(III) ***Value of in-force business***

The Group recognises as an asset the value of in-force business in respect of insurance contracts and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined after making appropriate assumptions about future economic and operating conditions such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

The Group's contractual rights to benefits from providing investment management services in relation to non-participating investment contracts acquired in business combinations and portfolio transfers is measured at fair value at the date of acquisition. The resulting asset is amortised over the estimated lives of the contracts. At each reporting date an assessment is made to determine if there is any indication of impairment. Where impairment exists, the carrying value of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement.

(2) *General insurance business*

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet

2 Accounting policies (continued)

within liabilities arising from insurance contracts and participating investment contracts and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims liabilities are not discounted.

(3) *Liability adequacy test*
At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities net of related deferred cost assets and value of in-force business. In performing these tests current best estimates of discounted future contractual cash flows and claims handling and policy administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the income statement, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from liability adequacy tests.

(4) *Reinsurance*
Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. Premiums payable for reinsurance contracts are recognised as an expense when due within insurance premium income. Changes in the reinsurance recoverable assets are recognised in the income statement through insurance claims.

p Foreign currency translation
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in sterling, which is the Bank's functional and presentation currency.

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items held at fair value through profit and loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on available-for-sale non-monetary financial assets, such as equity shares, are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

The results and financial position of all group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date.

The income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions.

Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income and accumulated in a separate component of equity together with exchange differences arising from the translation of borrowings and other currency instruments (see f(3)). On disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation are reclassified from equity and included in determining the profit or loss arising on disposal.

q Provisions
Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

r Dividends
Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid.

s Cash and cash equivalents
For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

t Investment in subsidiaries
Investments in subsidiaries are carried at historical cost, less any provisions for impairment.

3 Critical accounting estimates and judgements

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expense. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty in these financial statements and which together are deemed critical to the Group's results and financial position are discussed below.

Allowance for impairment losses on loans and receivables

The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in accounting policy 2(h). The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. Impairment allowances are established to recognise incurred impairment losses in the Group's loan portfolios carried at amortised cost. In determining whether an impairment has occurred at the balance sheet date the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows or their timings. Where this is the case, the impairment loss is the difference between the carrying value of the loan and the present value of the estimated future cash flows discounted at the loan's original effective interest rate.

At 31 December 2009 gross loans and receivables totalled £428,623 million (2008: £287,220 million) against which impairment allowances of £5,207 million (2008: £3,727 million) had been made (see note 20). Impairment allowances are made up of two components, those determined individually and those determined collectively. At 31 December 2009 the individual component was £1,951 million (2008: £964 million) and the collective component was £3,256 million (2008: £2,763 million).

Individual component

All impaired loans which exceed a certain threshold, principally within the Group's non-retail activities, are individually assessed for impairment having regard to expected future cash flows including those that could arise from the realisation of security. The determination of these allowances often requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer and the value of the security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in the current economic environment in assessing borrowers' cash flows and debt servicing capability together with the realisable value of commercial real estate collateral. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

Collective component

Impairment allowances for portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis. Collective impairment allowances are calculated on a portfolio basis using models which take into account factors such as historical experience of accounts progression through the various stages of delinquency, historical loss rates, the credit quality of the portfolio, and the value of any collateral held, which is estimated, where appropriate, using indices such as house price indices.

The calculation of the collective impairment allowance is therefore subject to estimation uncertainty. The variables used in the collective impairment models are kept under regular review to ensure that as far as possible they reflect current economic circumstances. However, significant management judgement is applied in assessing whether current economic conditions and borrowers' behaviour are fully reflected in the historical loss data and other inputs to the impairment models.

The collective impairment allowance is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is however inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

Given the relative size of the Group's retail mortgage portfolio, a key variable is UK house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices within the Group's mortgage portfolio were 10 per cent lower than those estimated at 31 December 2009, the house price index related impact on the impairment charge would be an increase of approximately £70 million.

Impairment of available-for-sale financial assets

In determining whether an impairment loss has been incurred in respect of an available-for-sale financial asset, the Group performs an objective review of the current financial circumstances and future prospects of the issuer and, in the case of equity shares, considers whether there has been a significant or prolonged decline in the fair value of that asset below its cost. This consideration requires management judgement. Among factors considered by the Group is whether the decline in fair value is a result of a change in the quality of the asset or a downward movement in the market as a whole. An assessment is performed of the future cash flows expected to be realised from the asset, taking into account, where appropriate, the quality of underlying security and credit protection available. The increase in the fair value of available-for-sale financial assets during the year was £1,430 million (2008: reduction of £2,721 million). Impairment losses in respect of available-for-sale financial assets transferred from reserves to the income statement totalled £25 million (2008: £130 million).

Valuation of financial instruments

Financial instruments classified by management as trading and other financial assets and liabilities at fair value through profit or loss, derivatives financial instruments and available-for-sale financial assets are carried at fair value which is determined as being the amount for which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Management judgement is required in determining the appropriate classification of financial instruments.

In 2009, the Group adopted '*Amendments to IFRS 7 'Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments'* which among other matters, established a three level valuation hierarchy for disclosure of fair value measurements of financial instruments carried on the Group's balance sheet at fair value.

3 Critical accounting estimates and judgements (continued)

Management judgement is required in determining the categorisation of the Group's financial instruments that are carried at fair value. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is less judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and level 3 is determined using valuation techniques which include discounted cash flow analysis and pricing models and, where appropriate, comparison to similar instruments. These require management judgment and therefore contain significant estimation uncertainty.

In particular significant judgement is required by management in determining appropriate assumptions to be used for level 3 financial instruments. In valuing Level 3 asset-backed securities and derivatives, such assumptions include prepayment rates, probability of default, loss given default and yield curves. In respect of the Group's unlisted equity investments, fair value is determined through the use of third party valuations which may be adjusted to take into account other relevant information that management judge to be relevant.

The valuation techniques used are set out in note 51. This provides details of the inputs into valuation models that have the potential to significantly impact the value determined, sets out the assumptions used for those inputs and provides the effects of applying reasonably possible alternative assumptions.

Taxation
At 31 December 2009 the Group had a net deferred tax asset of £2,438 million (2008: £837 million) and a net current tax asset of £63 million (2008: £440 million). The most significant judgement relates to utilisation of tax losses carried forward for which a deferred tax asset of £2,316 million (2008 £856 million) is recognised in respect of specific Group companies. The recognition of this deferred tax asset requires significant judgement regarding the future utilisation of these tax losses. This includes an assessment of management's projections of future taxable income based on business plans and ongoing tax planning strategies. These projections include assumptions about the future economic environment, particularly in the UK.

While the Group has taken account of tax issues that are subject to ongoing discussion with HM Revenue & Customs and other tax authorities in recognising tax assets. Inherent in this is management's assessment of legal and professional advice, case law and other relevant guidance. The various risks are categorised and appropriate weightings applied in determining the carrying value of current and deferred tax balances.

Pensions
The net liability recognised in the balance sheet at 31 December 2009 in respect of the Group's retirement benefit obligations was £474 million (2008: £1,771 million) of which £360 million (2008: £1,657 million) related to defined benefit pension schemes. As explained in accounting plicy 2(l), the Group adopts the corridor approach to accounting for pensions and consequently does not recognise actuarial losses of £2,361 million (2008: £267 million). The defined benefit pension schemes' gross deficit totalled £2,721 million (2008: £1,924 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

The schemes' liabilities are calculated using the projected unit credit method, which takes into account projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. The resulting estimated cash flows are discounted at a rate equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration and currency to the schemes' liabilities. In order to estimate the future cash flows, a number of financial and non-financial assumptions are made by management, changes to which could have a material impact upon the overall deficit or the net cost recognised in the income statement.

Two important assumptions are the rate of inflation and the expected lifetime of the schemes' members. The assumed rate of inflation affects the rate at which salaries are projected to grow and therefore the size of the pension that employees receive upon retirement and also the rate at which pensions in payment increase. Over the longer term rates of inflation can vary significantly. At 31 December 2009 it was assumed that the rate of inflation would be 3.4 per cent per annum (2008: 3.0 per cent), although if this was increased by 0.2 per cent the overall deficit would increase by approximately £511 million and the annual cost by approximately £60 million. A reduction of 0.2 per cent would reduce the overall deficit by approximately £489 million and the annual cost by approximately £52 million.

The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience. Assumptions used by management reflect recent longevity experience and extrapolate the improving trend. An increase of one year in the expected lifetime of scheme members would increase the overall deficit by approximately £393 million and the annual cost by approximately £64 million; a reduction of one year would reduce the overall deficit by approximately £399 million and the annual cost by approximately £61 million.

The size of the overall deficit is also sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variations. At 31 December 2009 the discount rate used was 5.7 per cent (2008: 6.3 per cent); a reduction of 0.2 per cent would increase the overall deficit by approximately £635 million and the annual cost by approximately £68 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £604 million and the annual cost by approximately £54 million.

Goodwill
At 31 December 2009 the Group carried goodwill on its balance sheet totalling £2,016 million (2008: £2,256 million), substantially all of which relates to acquisitions made a number of years ago.

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge is required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or performance does not meet expectations which affects the amount and timing of future cash flows, goodwill may become impaired in future periods. Further details are given in note 23.

Life insurance business
The Group carries in its balance sheet a value in-force asset, representing the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts, of £2,403 million at 31 December 2009 (2008: £1,893 million). The methodology used to value this asset is set out in accounting policy 2(o)(1). The valuation or recoverability of these assets requires assumptions to be made about future economic and operating conditions. These assumptions are inherently uncertain and changes could significantly affect the value attributed to these assets.

3 Critical accounting estimates and judgements (continued)

At 31 December 2009 the Group carried substantial liabilities to holders of life, pensions and investment contracts in its balance sheet. Liabilities arising from insurance contracts and participating investment contracts were £24,077 million and £12,273 million respectively (2008: £21,553 million and £11,619 million) and those arising from non-participating investment contracts totalled £15,734 million (2008: £14,243 million). The methodology used to value the liabilities is described in accounting policy 2(o)(1). Elements of the liability valuations require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour.

The process for determining key assumptions that have been made for life insurance assets and liabilities at 31 December 2009 is detailed in notes 24 and 33. The impact on profit before tax of changes in key assumptions is detailed in note 34.

General insurance business
At 31 December 2009 the Group held a provision of £223 million (2008: £183 million) in respect of the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The methodology for valuing these liabilities, which includes the use of statistical techniques, is described in accounting policy 2(o)(2).

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgement. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £21 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £22 million; some relief would arise from reinsurance contracts held.

4 Net interest income

	Weighted average effective interest rate			
	2009 %	2008 %	**2009 £m**	2008 £m
Interest and similar income:				
Loans and advances to customers	**3.95**	6.33	**9,086**	13,808
Loans and advances to banks	**0.89**	4.74	**1,335**	1,847
Debt securities held as loans and receivables	**4.35**	2.52	**123**	61
Lease and hire purchase receivables	**6.69**	7.62	**598**	706
Interest receivable on loans and receivables	**2.85**	6.10	**11,142**	16,422
Available-for-sale financial assets	**1.59**	4.58	**433**	1,147
Total interest and similar income	**2.77**	5.97	**11,575**	17,569
Interest and similar expense:				
Deposits from banks	**0.85**	3.65	**(723)**	(1,540)
Customer deposits	**1.23**	3.22	**(1,944)**	(4,946)
Debt securities in issue	**1.59**	4.19	**(1,642)**	(2,154)
Subordinated liabilities	**7.94**	6.28	**(1,242)**	(901)
Liabilities under sale and repurchase agreements	**1.83**	4.45	**(509)**	(256)
Interest payable on liabilities held at amortised cost	**1.56**	3.67	**(6,060)**	(9,797)
Other	**3.91**	–	**(216)**	–
Total interest and similar expense	**1.59**	3.61	**(6,276)**	(9,797)
Net interest income			**5,299**	7,772

Included within interest and similar income is £584 million (2008: £435 million) in respect of impaired financial assets. Net interest income also includes a credit of £17 million (2008: charge of £16 million) transferred from the cash flow hedging reserve (see note 44).

Notes to the accounts

5 Net fee and commission income

	2009 £m	2008 £m
Fee and commission income:		
Current accounts	**761**	707
Insurance broking	**125**	549
Credit and debit card fees	**564**	581
Trust and other fiduciary fees	**393**	413
Other	**978**	981
	2,821	3,231
Fee and commission expense	**(680)**	(694)
Net fee and commission income	**2,141**	2,537

As discussed in accounting policy 2(d), fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 4. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 6.

6 Net trading income

	2009 £m	2008 £m
Foreign exchange translation gains	**74**	58
Gains on foreign exchange trading transactions	**382**	75
Total foreign exchange	**456**	133
Investment property losses (note 22)	**(145)**	(1,058)
Securities and other (losses) gains (see below)	**6,903**	(8,330)
Net trading income	**7,214**	(9,255)

Securities and other (losses) gains comprise net gains arising on assets and liabilities held at fair value through profit or loss and for trading as follows:

	2009 £m	2008 £m
Net income (expense) arising on assets held at fair value through profit or loss:		
Loans and advances to banks and customers	**11**	20
Debt securities	**537**	918
Equity shares	**4,929**	(7,770)
Total net (expense) income arising on assets held at fair value through profit or loss	**5,477**	(6,832)
Net expense arising on liabilities held at fair value through profit or loss – debt securities in issue	**(119)**	(232)
Total net (losses) gains arising on assets and liabilities held at fair value through profit or loss	**5,358**	(7,064)
Net (losses) gains on financial instruments held for trading	**1,545**	(1,266)
Securities and other (losses) gains	**6,903**	(8,330)

7 Insurance premium income

	2009 £m	2008 £m
Life insurance		
Gross premiums	**3,753**	4,841
Ceded reinsurance premiums	**(183)**	(41)
Net earned premiums	**3,570**	4,800
Non-life insurance		
Gross premiums written	**596**	651
Ceded reinsurance premiums	**(34)**	(23)
Net premiums	**562**	628
Change in provision for unearned premiums (note 33(2))	**85**	(16)
Change in provision for ceded unearned premiums (note 33(2))	**11**	–
Net earned premiums	**658**	612
Total net earned premiums	**4,228**	5,412

Life insurance gross written premiums can be further analysed as follows:

	2009 £m	2008 £m
Life and pensions	**3,278**	4,182
Annuities	**462**	645
Other	**13**	14
Gross premiums	**3,753**	4,841

Non-life insurance gross written premiums can be further analysed as follows:

	2009 £m	2008 £m
Credit protection	**115**	203
Home	**476**	441
Health	**5**	7
	596	651

8 Other operating income

	2009 £m	2008 £m
Operating lease rental income	**409**	392
Rental income from investment properties (note 22)	**180**	209
Other rents receivable	**32**	32
Gains less losses on disposal of available-for-sale financial assets (note 44)	**1**	19
Movement in value of in-force business (note 24)	**510**	(325)
Gain on capital transactions	**1,773**	–
Other income	**402**	201
	3,307	528

During 2009, as part of the Group's management of capital, the Group exchanged certain existing subordinated debt securities for new securities as described below. These exchanges resulted in a gain on extinguishment of the existing liability of £1,773 million, being the difference between the carrying amount of the securities extinguished and the fair value of the new securities together with related fees and costs.

In January 2009, the Bank converted two issues of perpetual capital securities for preference shares issued by the Bank which resulted in a gain of £859 million.

In the first half of 2009, undated subordinated notes issued by the Bank were exchanged for innovative tier 1 securities and senior unsecured notes issued by the Bank. These exchanges resulted in a gain of £652 million.

In November 2009, as part of the restructuring plan that was a requirement for EC approval of state aid received by Lloyds Banking Group, the Group agreed to suspend the payment of coupons and dividends on certain of the Group's preference shares and preferred securities accounted for as debt for the two year period from 31 January 2010 to 31 January 2012. This suspension gave rise to a partial extinguishment of the original liability, equivalent to the present value of the suspended cash flows and resulted in a gain of £262 million.

9 Insurance claims

	2009 £m	2008 £m
Insurance claims comprise:		
Life insurance and participating investment contract		
Claims and surrenders:		
Change in gross liabilities	**(4,062)**	(4,710)
Change in reinsurers' share	**76**	65
	(3,986)	(4,645)
Change in insurance and participating investment contract liabilities (note 33(1)):		
Change in gross liabilities	**(3,178)**	4,357
Change in reinsurers' share	**25**	40
	(3,153)	4,397
Change in non-participating investment contract liabilities:		
Change in gross liabilities	**(2,179)**	3,016
Change in reinsurers' share of liabilities	**–**	–
	(2,179)	3,016
Change in unallocated surplus (note 36)	**(40)**	284
Total life insurance and participating investment contracts	**(9,358)**	3,052
Non-life insurance		
Claims and claims paid:		
Gross	**(233)**	(219)
Reinsurers' share	**3**	7
	(230)	(212)
Change in liabilities (note 33(2)):		
Gross	**(40)**	24
Reinsurers' share	**(2)**	(5)
	(42)	19
Total non-life insurance	**(272)**	(193)
Total insurance claims (expense) credit	**(9,630)**	2,859

	2009 £m	2008 £m
Life insurance gross claims can also be analysed as follows:		
Deaths	**(270)**	(289)
Maturities	**(1,596)**	(1,888)
Surrenders	**(1,589)**	(1,960)
Annuities	**(540)**	(516)
Other	**(67)**	(57)
	(4,062)	(4,710)

A non-life insurance claims development table is included in note 33.

10 Operating expenses

	2009 £m	2008 £m
Staff costs:		
Salaries	**2,364**	2,183
Social security costs	**194**	176
Pensions and other post-retirement benefit schemes (note 38)	**362**	235
Other staff costs	**788**	337
	3,708	2,931
Premises and equipment:		
Rent and rates	**348**	318
Hire of equipment	**10**	16
Repairs and maintenance	**175**	151
Other	**202**	165
	735	650
Other expenses:		
Communications and data processing	**561**	455
Advertising and promotion	**188**	194
Professional fees	**342**	224
Other	**516**	780
	1,607	1,653
Depreciation and amortisation:		
Depreciation of tangible fixed assets (note 26)	**681**	648
Amortisation of other intangible assets (note 25)	**52**	38
	733	686
Goodwill impairment charge (note 23)	**240**	100
Total operating expenses, excluding Government Asset Protection Scheme fee and subvention payment	**7,023**	6,020
Subvention payment (see below)	**3,000**	–
Government Asset Protection Scheme fee (see below)	**2,500**	–
Total operating expenses	**12,523**	6,020

In the year ended 31 December 2009, the Bank made a payment of £3,000 million (2008:£nil) to its fellow banking subsidiary, Bank of Scotland plc, to support its financial and reputational position and to facilitate the ongoing integration of the group's banking operations.

In relation to the Lloyds Banking Group's agreement not to enter into the Government Asset Protection Scheme, in the year ended 31 December 2009 the Bank paid a fee of £2,500 million (2008:£nil) to the UK Government.

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2009	2008
UK	**63,891**	64,355
Overseas	**2,124**	2,118
	66,015	66,473

Fees payable to the Bank's auditors

During the year the auditors earned the following fees:

	2009 £m	2008 £m
Fees payable for the audit of the Bank's current year annual report	**4.5**	4.3
Fees payable for other services:		
Audit of the Bank's subsidiaries pursuant to legislation	**3.6**	4.2
Other services supplied pursuant to legislation	**2.5**	2.6
Other services relating to taxation	**0.4**	0.5
Services relating to corporate finance transactions	**0.2**	0.4
All other services	**1.0**	1.0
Total fees payable to the Bank's auditors	**12.2**	13.0

During the year the auditors also earned fees payable by entities outside the consolidated Lloyds TSB Bank Group in respect of the following:

	2009 £m	2008 £m
Audits of the Group pension schemes	**0.2**	0.2
Audits of unconsolidated Open Ended Investment Companies managed by the Group	**0.6**	0.5
Reviews of the financial position of corporate and other borrowers	**7.3**	1.4
Acquisition due diligence and other work performed in respect of potential venture capital investments	**1.4**	1.0

11 Impairment

	2009 £m	2008 £m
Impairment losses on loans and receivables (note 20):		
Loans and advances to banks	**(3)**	135
Loans and advances to customers	**4,248**	2,584
Debt securities classified as loans and receivables	**108**	157
	4,353	2,876
Impairment of available-for-sale financial assets (note 3)	**25**	130
Other credit risk provisions (note 40)	**38**	6
Total impairment charged to the income statement	**4,416**	3,012

12 Taxation

	2009 £m	2008 £m
a Analysis of tax credit for the year		
UK corporation tax:		
Current tax on profit (loss) for the year	**(309)**	(642)
Adjustments in respect of prior years	**(128)**	(40)
	(437)	(682)
Double taxation relief	**–**	39
	(437)	(643)
Foreign tax:		
Current tax on profit (loss) for the year	**(111)**	(104)
Adjustments in respect of prior years	**7**	4
	(104)	(100)
Current tax charge	**(541)**	(743)
Deferred tax (note 39)		
Origination and reversal of temporary differences	**2,051**	614
Adjustments in respect of prior years	**95**	148
	2,146	762
Tax credit	**1,605**	19

The credit for tax on the profit for 2009 is based on a UK corporation tax rate of 28.0 per cent (2008: 28.5 per cent).

The above income tax credit on (loss) profit for the year is made up as follows:

	2009 £m	2008 £m
Tax (charge) credit attributable to policyholders	**(44)**	461
Shareholder tax credit (charge)	**1,649**	(442)
	1,605	19

Year ended 31 December 2009	Before tax amount £m	Total tax £m	After tax amount £m
Movements in available-for-sale financial assets:			
Change in fair value	**1,430**	**(228)**	**1,202**
Transferred to income statement in respect of disposals	**(1)**	**(2)**	**(3)**
Transferred to income statement in respect of impairment	**44**	**(6)**	**38**
Other transfers to income statement	**(29)**	**8**	**(21)**
	1,444	**(228)**	**1,216**
Movement in cash flow hedges:			
Effective portion of changes in fair value taken to other comprehensive income	**(4)**	**1**	**(3)**
Net gains transferred to the income statement	**(17)**	**5**	**(12)**
	(21)	**6**	**(15)**
Currency translation differences	**313**	**(182)**	**131**
Other comprehensive income for the year	**1,736**	**(404)**	**1,332**

12 Taxation (continued)

Year ended 31 December 2008	Before tax amount £m	Total tax £m	After tax amount £m
Movements in available-for-sale financial assets:			
Change in fair value	(2,721)	690	(2,031)
Transferred to income statement in respect of disposals	(19)	–	(19)
Transferred to income statement in respect of impairment	130	(28)	102
Other transfers to income statement	(91)	25	(66)
	(2,701)	687	(2,014)
Movement in cash flow hedges:			
Effective portion of changes in fair value taken to other comprehensive income	(33)	9	(24)
Net gains transferred to the income statement	16	(4)	12
	(17)	5	(12)
Currency translation differences	(1,301)	942	(359)
Other comprehensive income for the year	(4,019)	1,634	(2,385)

b Factors affecting the tax credit for the year

A reconciliation of the credit (charge) that would result from applying the standard UK corporation tax rate to profit before tax to the tax credit for the year is given below:

	2009 £m	2008 £m
Profit (loss) before tax	**(4,378)**	825
Tax (charge) credit thereon at UK corporation tax rate of 28.0 per cent (2008: 28.5 per cent)	**1,226**	(235)
Factors affecting credit (charge):		
Goodwill	**(67)**	(28)
Disallowed and non-taxable items	**463**	(122)
Overseas tax rate differences	**(13)**	(39)
Gains exempted or covered by capital losses	**14**	25
Policyholder interests	**(32)**	330
Adjustments in respect of previous years	**12**	94
Effect of profit (loss) in joint ventures and associates	**1**	–
Other items	**1**	(6)
Tax credit on profit (loss) on ordinary activities	**1,605**	19

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

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Trading assets	**510**	857	**510**	857
Other financial assets at fair value through profit or loss	**48,384**	44,258	**2,123**	2,822
	48,894	45,115	**2,633**	3,679

These assets are comprised as follows:

	2009		2008		**2009**		2008	
	Trading assets £m	**Other financial assets at fair value through profit or loss £m**	Trading assets £m	Other financial assets at fair value through profit or loss £m	**Trading assets £m**	**Other financial assets at fair value through profit or loss £m**	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to customers	**273**	**166**	283	325	**273**	**166**	283	325
Debt securities:								
Government securities	**72**	**7,866**	38	7,326	**72**	**–**	38	–
Other public sector securities	**6**	**34**	–	18	**6**	**–**	–	–
Bank and building society certificates of deposit	**–**	**–**	–	433	**–**	**–**	–	–
Asset-backed securities:								
Mortgage-backed securities	**–**	**393**	–	369	**–**	**–**	–	–
Other asset-backed securities	**–**	**1,656**	–	1,342	**–**	**247**	–	105
Corporate and other debt securities	**159**	**10,412**	536	11,120	**159**	**1,706**	536	2,387
	237	**20,361**	574	20,608	**237**	**1,953**	574	2,492
Equity shares:								
Listed	**–**	**18,964**	–	16,620	**–**	**–**	–	–
Unlisted	**–**	**8,893**	–	6,705	**–**	**4**	–	5
	–	**27,857**	–	23,325	**–**	**4**	–	5
	510	**48,384**	857	44,258	**510**	**2,123**	857	2,822

At 31 December 2009 £48,307 million (2008: £44,097 million) of trading and other financial assets at fair value through profit or loss of the Group and £2,478 million (2008: £3,376 million) of the Bank had a contractual residual maturity of greater than one year.

Other financial assets at fair value through profit or loss represent the following assets designated into that category:

(i) financial assets backing insurance contracts and investment contracts which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise;

(ii) certain loans and advances to customers which are economically hedged by interest rate derivatives which are not in hedge accounting relationships and where significant measurement inconsistencies would otherwise arise if the related derivatives were treated as trading liabilities and the loans and advances were carried at amortised cost; and

(iii) certain private equity investments that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

The maximum exposure to credit risk at 31 December 2009 of the loans and advances to customers designated at fair value through profit or loss by the Bank and the Group was £166 million (2008: £325 million); the Bank and the Group do not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk; this is determined by reference to the publicly available credit ratings of the instruments involved.

14 Derivative financial instruments

The Group holds derivatives as part of the following strategies:

– Customer driven, where derivatives are held as part of the provision of risk management products to Group customers;

– To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value, cash flow and net investment hedge approaches as described in Note 50;

– Derivatives held in policyholders funds as permitted by the investment strategies of these funds.

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS39. Derivatives are held at fair value on the Group's balance sheet. A description of the methodology used to determine the fair value of derivative financial instruments and the effect of using reasonably possible alternative assumptions for those derivatives valued using unobservable inputs is set out in note 50.

14 Derivative financial instruments (continued)

The principal derivatives used by the Group are as follows:

- Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.
- Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.
- Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. The Group also uses credit default swaps to securitise, in combination with external funding, £6,455 million (2008: £8,360 million) of corporate and commercial banking loans.
- Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date.

The fair value and notional amounts of derivative instruments held for trading are set out in the following table:

The Group	**2009**			2008		
	Contract/ notional amount £m	**Fair values Assets £m**	**Fair values Liabilities £m**	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**139,295**	**1,571**	**1,594**	157,572	5,788	4,102
Currency swaps	**45,684**	**2,594**	**1,485**	31,874	4,367	2,409
Options purchased	**11,286**	**684**	**–**	9,185	714	–
Options written	**11,133**	**–**	**437**	10,143	–	743
	207,398	**4,849**	**3,516**	208,774	10,869	7,254
Interest rate contracts:						
Interest rate swaps	**507,684**	**9,727**	**10,588**	370,333	11,797	12,990
Forward rate agreements	**108,567**	**70**	**49**	153,930	405	395
Options purchased	**50,339**	**1,076**	**–**	37,175	843	–
Options written	**33,991**	**–**	**1,089**	33,130	–	627
Futures	**635**	**1**	**1**	587	44	3
	701,216	**10,874**	**11,727**	595,155	13,089	14,015
Credit derivatives	**15,869**	**1,558**	**433**	32,495	4,257	2,670
Equity and other contracts	**14,592**	**521**	**355**	5,447	234	81
Total derivative assets/liabilities held for trading	**939,075**	**17,802**	**16,031**	841,871	28,449	24,020
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps (including swap options)	**24,219**	**950**	**492**	37,243	434	1,665
Options written	**628**	**–**	**144**	–	–	–
Derivatives designated as cash flow hedges:						
Interest rate swaps	**659**	**1**	**47**	867	1	91
Derivatives designated as net investment hedges:						
Cross currency swaps	**2,507**	**44**	**19**	6,318	–	2,413
Total derivative assets/liabilities held for hedging	**28,013**	**995**	**702**	44,428	435	4,169
Total recognised derivative assets/liabilities	**967,088**	**18,797**	**16,733**	886,299	28,884	28,189

14 Derivative financial instruments (continued)

At 31 December 2009 £3,776 million of total recognised derivative assets of the Group and £3,134 million of total recognised derivative liabilities of the Group (2008: £16,200 million of assets and £15,814 million of liabilities) had a contractual residual maturity of greater than one year.

The Bank	**2009**			2008		
	Contract/ notional amount £m	**Fair values Assets £m**	**Fair values Liabilities £m**	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**167,889**	**1,572**	**1,640**	165,836	5,783	4,228
Currency swaps	**47,703**	**1,804**	**1,504**	36,549	2,372	4,840
Options purchased	**11,272**	**685**	**–**	9,220	722	–
Options written	**11,152**	**–**	**439**	10,204	–	763
	238,016	**4,061**	**3,583**	221,809	8,877	9,831
Interest rate contracts:						
Interest rate swaps	**509,259**	**9,739**	**10,401**	374,626	11,663	12,708
Forward rate agreements	**108,567**	**70**	**48**	154,330	405	395
Options purchased	**48,083**	**1,068**	**–**	37,317	859	–
Options written	**34,368**	**–**	**1,101**	33,564	–	639
Futures	**4**	**–**	**1**	–	–	–
	700,281	**10,877**	**11,551**	599,837	12,927	13,742
Credit derivatives	**15,532**	**1,558**	**439**	39,888	4,257	3,986
Equity and other contracts	**10,368**	**489**	**484**	7,344	208	208
Total derivative assets/liabilities held for trading	**964,197**	**16,985**	**16,057**	868,878	26,269	27,767
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps (including swap options)	**23,219**	**951**	**581**	38,243	434	1,872
Options written	**628**	**–**	**144**	–	–	–
Derivatives designated as cash flow hedges:						
Interest rate swaps	**659**	**1**	**47**	867	1	91
Total derivative assets/liabilities held for hedging	**24,506**	**952**	**772**	39,110	435	1,963
Total recognised derivative assets/liabilities	**988,703**	**17,937**	**16,829**	907,988	26,704	29,730

At 31 December 2009 £2,478 million of total recognised derivative assets of the Bank and £4,225 million of total recognised derivative liabilities of the Bank (2008: £14,187 million of assets and £15,796 million of liabilities) had a contractual residual maturity of greater than one year.

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group and Bank should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in Note 51.

15 Loans and advances to banks

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Lending to banks	**153,826**	3,056	**169,882**	12,293
Money market placements with banks	**21,877**	35,812	**6,823**	24,810
Total loans and advances to banks	**175,703**	38,868	**176,705**	37,103
Allowance for impairment losses (note 20)	**(149)**	(135)	**(149)**	(135)
	175,554	38,733	**176,556**	36,968

At 31 December 2009 £3,174 million (2008: £5,459 million) of loans and advances to banks of the Group and £3,789 million (2008: £4,460 million) of the Bank had a contractual residual maturity of greater than one year.

The Group and the Bank hold collateral with a fair value of £4,171 million (2008: £10,739 million), which they are permitted to sell or repledge, of which £4,171 million (2008: £5,492 million) was repledged or sold to third parties for periods not exceeding three months from the transfer. The Bank and the Group are obliged to return collateral with a fair value of £4,171 million (2008: £5,492 million).

16 Loans and advances to customers

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Agriculture, forestry and fishing	**4,457**	3,969	**2,198**	2,017
Energy and water supply	**2,085**	2,598	**2,056**	2,577
Manufacturing	**8,807**	12,057	**7,880**	11,074
Construction	**2,842**	3,016	**2,427**	2,654
Transport, distribution and hotels	**12,280**	14,664	**10,357**	12,773
Postal and telecommunications	**833**	1,060	**790**	991
Property companies	**23,110**	23,318	**21,439**	21,610
Financial, business and other services	**32,889**	33,319	**27,200**	25,414
Personal:				
Mortgages	**115,349**	114,643	**101,922**	100,925
Other	**23,658**	25,318	**18,734**	20,575
Lease financing	**4,317**	4,546	**483**	590
Hire purchase	**5,224**	5,295	**528**	576
Due from fellow Group undertakings	**14,188**	–	**60,692**	50,287
	250,039	243,803	**256,706**	252,063
Allowance for impairment losses (note 20)	**(4,813)**	(3,459)	**(3,595)**	(2,700)
	245,226	240,344	**253,111**	249,363

At 31 December 2009 £190,831 million (2008: £180,197 million) of loans and advances to customers of the Group and £163,944 million (2008: £158,176 million) of the Bank had a contractual residual maturity of greater than one year.

The Group and the Bank hold collateral with a fair value of £1,110 million (2008: £1,736 million), which they are permitted to sell or repledge, of which £1,102 million (2008: £366 million) was repledged or sold to third parties for periods not exceeding three months from the transfer. The Group and the Bank are obliged to return collateral with a fair value of £1,102 million (2008: £366 million).

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Gross investment in finance leases, receivable:				
Not later than 1 year	**648**	541	**48**	54
Later than 1 year and not later than 5 years	**1,473**	1,775	**148**	205
Later than 5 years	**4,922**	5,570	**638**	748
	7,043	7,886	**834**	1,007
Unearned future finance income on finance leases	**(2,599)**	(3,038)	**(353)**	(416)
Rentals received in advance	**(119)**	(128)	**2**	(1)
Commitments for expenditure in respect of equipment to be leased	**(8)**	(174)	**–**	–
Net investment in finance leases	**4,317**	4,546	**483**	590

The net investment in finance leases represents amounts recoverable as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Not later than 1 year	**364**	328	**21**	25
Later than 1 year and not later than 5 years	**892**	974	**84**	116
Later than 5 years	**3,061**	3,244	**378**	449
	4,317	4,546	**483**	590

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2009 and 2008 no contingent rentals in respect of finance leases were recognised in the income statement. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £19 million for the Group (2008: £15 million).

16 Loans and advances to customers (continued)

The unguaranteed residual values included in finance lease receivables were as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Not later than 1 year	**4**	1	**–**	–
Later than 1 year and not later than 5 years	**46**	29	**17**	15
Later than 5 years	**5**	3	**–**	–
Total	**55**	33	**17**	15

17 Securitisations and covered bonds

Loans and advances to customers include balances that have been securitised but not derecognised, including residential mortgages and commercial banking loans, the carrying values of which are set out below together with any related liabilities. Residential mortgages are not derecognised because the Group remains exposed to the majority of the risk of any default in respect of them; commercial banking loans are not derecognised because the Group has not transferred the contractual rights to receive the cash flows from those loans nor has it assumed a contractual obligation to pay the cash flows from those loans to a third party.

Beneficial interests in certain residential mortgages have been transferred to special purpose entities which issue floating rate debt securities. Neither the Group nor any entities in the Group are obliged to support any losses that may be suffered by the note holders and do not intend to offer such support. The floating rate note holders only receive payments of interest and principal to the extent that the special purpose entities have received sufficient funds from the transferred mortgages and after certain expenses have been met. In the event of a deficiency, they have no recourse whatsoever to the Group.

The Group's principal securitisation and covered bonds programmes, together with the balances of the advances subject to notes in issue at 31 December, are listed below. The notes in issue are reported in note 32.

		2009		2008	
Securitisation	Type of loan	**Gross assets securitised £m**	**Notes in issue £m**	Gross assets securitised £m	Notes in issue £m
Arkle	UK residential mortgages	**32,070**	**18,420**	34,293	27,189
Coopers Hill	UK residential mortgages	**11,383**	**12,000**	–	–
Highland	UK residential mortgages	**5,937**	**6,050**	–	–
Ascot Black[1]	Commercial loans	**1,220**	**–**	1,434	–
Goodwood Gold[1]	Commercial loans	**2,932**	**119**	2,909	127
Doncaster Gold[1]	Commercial loans	**831**	**60**	950	48
Exeter Blue[1]	PPP/PFI and project finance loans	**877**	**45**	859	48
Kelso[1]	Corporate loans and revolving credit facilities	**595**	**7**	1,158	3
Morse[1]	Corporate loans and revolving credit facilities	**–**	**–**	1,050	–
Chepstow Blue	Commercial loans	**3,959**	**4,050**	–	–
Derby Blue	Commercial loans	**3,231**	**3,250**	–	–
		63,035	**44,001**	42,653	27,415
Less held by the Group			**(37,438)**		(17,365)
Total securitisations			**6,563**		10,050
Covered bonds					
Residential mortgage-backed covered bonds		**38,753**	**29,000**	40,608	24,000
Less held by the Group			**(29,000)**		(24,000)
Total covered bonds			**–**		–
Total securitisations and covered bonds			**6,563**		10,050

[1]Securitisations using a combination of external funding and credit default swaps.

Cash deposits of £7,209 million (2008: £1,846 million) held by the Group are restricted in use to repayment of the debt securities issued by the special purpose entities and other legal obligations.

18 Special purpose entities

In addition to the special purpose entities disclosed in note 17, which are used for securitisation and covered bond programmes, the Group sponsors Cancara, an asset-backed conduit which invests in debt securities and client receivables. The total exposures in Cancara, all of which are consolidated in the Group's financial statements, are set out in the table below:

	2009 £m	2008 £m
Loans and advances (note 16)	**3,692**	5,905
Debt securities:		
Classified as loans and receivables (note 19)	**10**	437
Classified as available-for-sale (note 21)	**5,382**	6,273
Total exposure	**9,084**	12,615

Other special purpose entities

During 2009, the Group established Lloyds TSB Pension ABCS (No 1) LLP and Lloyds TSB Pension ABCS (No 2) LLP and transferred approximately £5 billion of assets, primarily comprising notes in certain of the Group's securitisation programmes, in aggregate to these entities. The Group transferred interests in these LLPs with a fair value of approximately £1 billion in aggregate to the Lloyds TSB Group Pension Scheme No 1 and the Lloyds TSB Group Pension Scheme No 2 entitling those schemes to annual payments of approximately £215 million in aggregate until 31 December 2014 (see note 38).

19 Debt securities classified as loans and receivables

Debt securities accounted for as loans and receivables comprise:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Asset-backed securities:				
Mortgage-backed securities	**600**	478	**590**	–
Other asset-backed securities	**313**	540	**518**	540
Corporate and other debt securities	**1,968**	3,531	**1,967**	3,456
	2,881	4,549	**3,075**	3,996
Allowance for impairment losses (see note 20)	**(245)**	(133)	**(245)**	(133)
	2,636	4,416	**2,830**	3,863

Included above are £10 million (2008: £437 million) held in Cancara, the Group's asset-backed commercial paper conduit (see note 18).

20 Allowance for impairment losses on loans and receivables

The Group	Loans and advances to customers £m	Loans and advances to banks £m	Debt securities £m	Total £m
Balance at 1 January 2008	2,408	–	–	2,408
Exchange and other adjustments	43	–	–	43
Advances written off	(1,586)	–	(24)	(1,610)
Recoveries of advances written off in previous years	112	–	–	112
Unwinding of discount	(102)	–	–	(102)
Charge to the income statement	2,584	135	157	2,876
At 31 December 2008	**3,459**	**135**	**133**	**3,727**
Exchange and other adjustments	**(17)**	**17**	**4**	**4**
Advances written off	**(2,896)**	**–**	**–**	**(2,896)**
Recoveries of advances written off in previous years	**110**	**–**	**–**	**110**
Unwinding of discount	**(91)**	**–**	**–**	**(91)**
Charge (credit) to the income statement	**4,248**	**(3)**	**108**	**4,353**
At 31 December 2009	**4,813**	**149**	**245**	**5,207**

The Bank	Loans and advances to customers £m	Loans and advances to banks £m	Debt securities £m	Total £m
Balance at 1 January 2008	1,855	–	–	1,855
Exchange and other adjustments	43	–	–	43
Advances written off	(1,397)	–	–	(1,397)
Recoveries of advances written off in previous years	103	–	–	103
Unwinding of discount	(108)	–	–	(108)
Charge to the income statement	2,204	135	133	2,472
At 31 December 2008	**2,700**	**135**	**133**	**2,968**
Exchange and other adjustments	**(20)**	**17**	**(1)**	**(4)**
Advances written off	**(2,619)**	**–**	**–**	**(2,619)**
Recoveries of advances written off in previous years	**107**	**–**	**–**	**107**
Unwinding of discount	**(98)**	**–**	**–**	**(98)**
Charge (credit) to the income statement	**3,525**	**(3)**	**113**	**3,635**
At 31 December 2009	**3,595**	**149**	**245**	**3,989**

21 Available-for-sale financial assets

The Group	2009 Cancara £m	2009 Other £m	2009 Total £m	2008 Cancara £m	2008 Other £m	2008 Total £m
Debt securities:						
Government securities	–	**8,342**	**8,342**	–	868	868
Other public sector securities	–	**31**	**31**	–	12	12
Bank and building society certificates of deposit	–	**729**	**729**	–	9,602	9,602
Asset-backed securities:						
Mortgage-backed securities	**3,481**	**1,283**	**4,764**	3,929	1,771	5,700
Other asset-backed securities	**1,901**	**5,660**	**7,561**	2,344	5,748	8,092
Corporate and other debt securities	–	**2,049**	**2,049**	–	2,183	2,183
	5,382	**18,094**	**23,476**	6,273	20,184	26,457
Equity shares:						
Listed	–	**4**	**4**	–	3	3
Unlisted	–	**77**	**77**	–	38	38
	–	**81**	**81**	–	41	41
Treasury bills and other bills:						
Treasury bills and similar securities	–	**2,532**	**2,532**	–	2,402	2,402
Other bills	–	–	–	–	26,807	26,807
	–	**2,532**	**2,532**	–	29,209	29,209
	5,382	**20,707**	**26,089**	6,273	49,434	55,707

The Bank	2009 £m	2008 £m
Debt securities:		
Government securities	**8,200**	510
Other public sector securities	**31**	12
Bank and building society certificates of deposit	**463**	7,663
Asset-backed securities:		
Mortgage-backed securities	**1,080**	19,276
Other asset-backed securities	**2,122**	3,576
Corporate and other debt securities	**1,471**	514
	13,367	31,551
Equity shares:		
Listed	**1**	–
Unlisted	**75**	36
	76	36
Treasury bills and other bills:		
Treasury bills and similar securities	**71**	50
Other bills	–	26,807
	71	26,857
	13,514	58,444

Details of the Group's asset-backed conduits shown in the table above are included in note 18.

Further information on asset-backed security exposures is provided in note 51.

At 31 December 2009 £21,352 million (2008: £15,627 million) of available-for-sale financial assets of the Group and £12,546 million (2008: £17,331 million) of the Bank had a contractual residual maturity of greater than one year.

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in accounting policy 2(h)(2). Included in available-for-sale financial assets at 31 December 2009 are debt securities individually determined to be impaired whose gross amount before impairment allowances was £32 million (2008: £282 million) and in respect of which no collateral was held. In addition, included in available-for-sale financial assets at 31 December 2009 are equity securities individually determined to be impaired whose gross amount before impairment allowances was £nil (2008: £31 million).

At 31 December 2009, the Bank had sold £1,277 million (2008: £478 million) of debt securities to two of its subsidiary undertakings; however the related agreements are such that the Bank has retained substantially all of the risks and rewards of ownership and, as a consequence, the debt securities continue to be recognised on the Bank's balance sheet.

Notes to the accounts

22 Investment properties of the Group

	2009 £m	2008 £m
At 1 January	**2,631**	3,722
Exchange and other adjustments	**(15)**	66
Additions:		
Acquisitions of new properties	**82**	85
Additional expenditure on existing properties	**67**	116
Total additions	**149**	201
Disposals	**(280)**	(300)
Changes in fair value (note 6)	**(145)**	(1,058)
At 31 December	**2,340**	2,631

The investment properties are valued at least annually at open-market value, by independent, professionally qualified valuers, who have recent experience in the location and categories of the investment properties being valued.

In addition the following amounts have been recognised in the income statement:

	2009 £m	2008 £m
Rental income	**180**	209
Direct operating expenses arising from investment properties that generate rental income	**37**	29

Capital expenditure in respect of investment properties:

	2009 £m	2008 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	**9**	82

23 Goodwill of the Group

	2009 £m	2008 £m
At 1 January	**2,256**	2,358
Exchange and other adjustments	**–**	(2)
Impairment charged to the income statement	**(240)**	(100)
At 31 December	**2,016**	2,256
Cost*	**2,362**	2,362
Accumulated impairment losses	**(346)**	(106)
At 31 December	**2,016**	2,256

*For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is included net of amounts amortised up to 31 December 2003.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,016 million (31 December 2008: £2,256 million), £1,836 million (or 91 per cent of the total) has been allocated to Scottish Widows and £170 million (or 8 per cent of the total) to Asset Finance.

The recoverable amount of Scottish Widows has been based on a value-in-use calculation. The calculation uses projections of future cash flows based upon budgets and plans approved by management covering a five-year period, and a discount rate of 12 per cent (gross of tax). The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. Cash flows beyond the five-year period have been extrapolated using a steady 3 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

In 2009, the markets in which the Consumer Finance unit of Asset Finance operate have deteriorated further with both macroeconomic and market conditions worsening, leading to a fall off in demand and increasing arrears. This, together with continuing uncertainties over the likely short-term macroeconomic environment, has resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £240 million in the year ended 31 December 2009 reflecting the write down of the entire balance of goodwill allocated to the Consumer Finance unit of Asset Finance leaving goodwill of £170 million in the Autolease unit of Asset Finance.

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 18.75 per cent (gross of tax). The cash flows beyond the five-year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Asset Finance participates.

24 Value of in-force business of the Group

The movement in the value of in-force insurance and participating investment contracts over the year is as follows:

	2009 £m	2008 £m
At 1 January	**1,893**	2,218
Movements in the year:		
New business	**201**	368
Existing business:		
Expected return	**(111)**	(112)
Experience variances	**(28)**	(46)
Assumption changes	**16**	(92)
Economic variance	**432**	(443)
Movement in value of in-force business taken to income statement (note 8)	**510**	(325)
At 31 December	**2,403**	1,893

This breakdown shows the movement in the value of in-force business only, and does not represent the full contribution that each item in the breakdown contributes to profit before tax, which would also contain changes in the other assets and liabilities of the relevant businesses. Economic variance is the element of earnings which is generated from changes to economic experience in the period and to assumptions over time. The presentation of economic variance includes the impact of financial market conditions being different at the end of the reporting period from those included in assumptions used to calculate new and existing business returns.

The principal features of the methodology and process used for determining key assumptions used in the calculation of the value of in-force business are set out below:

Economic assumptions

Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn the risk-free rate and all cash flows are discounted at the risk-free rate.

A market consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date. The risk-free rate used for the value of financial options and guarantees is defined as the spot yield derived from the relevant government bond yield curve in line with FSA realistic balance sheet assumptions.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. In accordance with the approach adopted in December 2008, the value of the in-force business asset for UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of these corporate bond holdings. The illiquidity premium is estimated to be 75 basis points as at 31 December 2009 (31 December 2008: 154 basis points). The reduction in the illiquidity premium over 2009 has offset gains made on the assets backing the annuity liabilities, reducing the benefit within the results from the reduction in corporate bond spreads.

The risk-free rate assumed in valuing the non-annuity in-force business is the 15 year government bond yield for the appropriate territory. The risk-free rate assumed in valuing the in-force asset for the UK annuity business is presented as a single risk free rate to allow a better comparison to the rate used for other business. That single risk-free rate has been derived to give the equivalent value to the UK annuity book, had that book been valued using the UK gilt yield curve increased to reflect the illiquidity premium described above.

The table below shows the range of resulting yields and other key assumptions at 31 December for UK business:

	2009 %	2008 %
Risk-free rate (value of in-force non-annuity business)	**4.45**	3.74
Risk-free rate (value of in-force annuity business)	**5.05**	5.22
Risk-free rate (financial options and guarantees)	**0.87 to 4.76**	1.11 to 4.24
Retail price inflation	**3.64**	2.75
Expense inflation	**4.42**	3.50

Non-market risk

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the With Profit Fund these can be asymmetric in the range of potential outcomes for which an explicit allowance is made.

Non-economic assumptions

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience.

Further information about the effect of changes in key assumptions is given in note 34.

Notes to the accounts

25 Other intangible assets

	The Group			The Bank
	Customer related intangibles £m	Capitalised software enhance-ments £m	Total £m	Capitalised software enhance-ments £m
Cost:				
At 1 January 2008	57	240	297	156
Additions	6	80	86	65
At 31 December 2008	**63**	**320**	**383**	**221**
Additions	**–**	**60**	**60**	**38**
Disposals	**–**	**(69)**	**(69)**	**(69)**
At 31 December 2009	**63**	**311**	**374**	**190**
Accumulated amortisation:				
At 1 January 2008	5	143	148	103
Charge for the year	7	31	38	18
At 31 December 2008	**12**	**174**	**186**	**121**
Charge for the year	**6**	**46**	**52**	**27**
Disposals	**–**	**(69)**	**(69)**	**(69)**
At 31 December 2009	**18**	**151**	**169**	**79**
Balance sheet amount at 31 December 2009	**45**	**160**	**205**	**111**
Balance sheet amount at 31 December 2008	51	146	197	100

Capitalised software enhancements of the Bank and the Group principally comprise identifiable and directly associated internal staff and other costs.

26 Tangible fixed assets

	The Group				The Bank		
	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m	Premises £m	Equipment £m	Total tangible fixed assets £m
Cost:							
At 1 January 2008	1,437	2,871	1,431	5,739	1,083	2,426	3,509
Exchange and other adjustments	2	18	70	90	2	18	20
Additions	96	341	556	993	91	316	407
Disposals	(19)	(82)	(493)	(594)	(16)	(40)	(56)
At 31 December 2008	**1,516**	**3,148**	**1,564**	**6,228**	**1,160**	**2,720**	**3,880**
Exchange and other adjustments	**–**	**(28)**	**358**	**330**	**(2)**	**(8)**	**(10)**
Additions	**53**	**1,200**	**584**	**1,837**	**49**	**354**	**403**
Disposals	**(25)**	**(93)**	**(422)**	**(540)**	**(23)**	**(83)**	**(106)**
At 31 December 2009	**1,544**	**4,227**	**2,084**	**7,855**	**1,184**	**2,983**	**4,167**
Accumulated depreciation and impairment:							
At 1 January 2008	718	2,007	175	2,900	637	1,637	2,274
Exchange and other adjustments	1	10	21	32	1	10	11
Charge for the year	81	254	313	648	71	228	299
Disposals	(11)	(63)	(243)	(317)	(9)	(28)	(37)
At 31 December 2008	**789**	**2,208**	**266**	**3,263**	**700**	**1,847**	**2,547**
Exchange and other adjustments	**–**	**(4)**	**108**	**104**	**(3)**	**(4)**	**(7)**
Charge for the year	**83**	**265**	**333**	**681**	**72**	**240**	**312**
Disposals	**(18)**	**(49)**	**(251)**	**(318)**	**(18)**	**(41)**	**(59)**
At 31 December 2009	**854**	**2,420**	**456**	**3,730**	**751**	**2,042**	**2,793**
Balance sheet amount at 31 December 2009	**690**	**1,807**	**1,628**	**4,125**	**433**	**941**	**1,374**
Balance sheet amount at 31 December 2008	727	940	1,298	2,965	460	873	1,333

26 Tangible fixed assets (continued)

At 31 December the future minimum rentals receivable by the Group under non-cancellable operating leases were as follows:	**2009 £m**	2008 £m
Receivable within 1 year	**418**	294
1 to 5 years	**562**	320
Over 5 years	**37**	9
	1,017	623

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2008 and 2009 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £72 million for the Group and £64 million for the Bank at 31 December 2009 (£102 million for the Group and £93 million for the Bank at 31 December 2008) is expected to be received under non-cancellable sub-leases of premises.

27 Investment in subsidiary undertakings of the Bank

	2009 £m	2008 £m
At 1 January	**15,992**	16,137
Additions	**–**	817
Additional capital injections and transfers	**1**	50
Capital repayments	**–**	(805)
Disposals	**(33)**	(187)
Permanent diminution in value	**–**	(20)
At 31 December	**15,960**	15,992

The principal group undertakings, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds TSB Bank plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Scotland plc	Scotland	100%	Banking and financial services
Scottish Widows plc	Scotland	100%*	Life assurance

*Indirect interest.

The principal area of operation for each of the above group undertakings is the United Kingdom.

In November 2009, as part of the restructuring plan that was a requirement for European Community (EC) approval of state aid received by the Group, Lloyds Banking Group agreed to suspend the payment of coupons and dividends on certain of the Group preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. The Group has agreed to temporarily suspend and/or waive dividend payments on certain preference shares which have been issued intra-group. Consequently, in accordance with the terms of some of these instruments, subsidiaries may be prevented from making dividend payments on ordinary shares during this period. In addition, certain subsidiary companies currently have insufficient distributable reserves to make dividend payments.

Subject to the foregoing, there were no further significant restrictions on any of the parent company's subsidiaries in paying dividends or repaying loans and advances. All regulated banking and insurance subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

See note 55, post balance sheet events, for details of the acquisition of HBOS plc on 1 Jan 2010.

28 Other assets

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Assets arising from reinsurance contracts held (note 33)	**419**	385	**–**	–
Deferred acquisition and origination costs	**188**	196	**–**	–
Settlement balances	**152**	751	**13**	493
Other assets and prepayments	**4,223**	4,432	**803**	1,999
	4,982	5,764	**816**	2,492

	2009 £m	2008 £m
Deferred acquisition and origination costs of the Group:		
At 1 January	**196**	212
Acquisition and origination costs deferred, net of amounts amortised to the income statement	**(8)**	(16)
At 31 December	**188**	196

29 Deposits from banks

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Liabilities in respect of securities sold under repurchase agreements	**48,803**	24,888	**48,803**	24,888
Other deposits from banks	**90,754**	41,626	**111,625**	55,641
	139,557	66,514	**160,428**	80,529

At 31 December 2009 £911 million (2008: £1,956 million) of deposits from banks of the Group and £2,769 million (2008: £2,489 million) of the Bank had a contractual residual maturity of greater than one year.

Included in deposits from banks, for both the Group and the Bank, were deposits of £1,834 million (2008: £2,574 million) held as collateral, principally in relation to derivative contracts. The fair value of those deposits approximates the carrying amount.

30 Customer deposits

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Non-interest bearing current accounts	**6,793**	4,176	**6,272**	3,936
Interest bearing current accounts	**47,738**	47,109	**45,109**	44,101
Savings and investment accounts	**75,682**	76,144	**67,168**	64,653
Liabilities in respect of securities sold under repurchase agreements	**224**	92	**226**	92
Other customer deposits	**62,608**	44,843	**82,278**	71,259
Customer deposits	**193,045**	172,364	**201,053**	184,041

At 31 December 2009 £19,005 million (2008: £3,166 million) of customer deposits of the Group and £22,928 million (2008: £9,476 million) of the Bank had a contractual residual maturity of greater than one year.

Included in customer deposits were deposits of £651 million (2008: £1,002 million) of the Group and £651 million (2008: £982 million) of the Bank held as collateral, principally in relation to derivative contracts. The fair value of those deposits approximates the carrying amount.

31 Trading and other financial liabilities at fair value through profit or loss

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Liabilities held at fair value through profit or loss (debt securities)	**6,160**	6,748	**6,160**	6,748
Trading liabilities – short positions in securities	**202**	6	**202**	6
Trading and other financial liabilities at fair value through profit or loss	**6,362**	6,754	**6,362**	6,754

At 31 December 2009, for both the Group and the Bank, £4,057 million (2008: £6,525 million) of trading and other liabilities at fair value through profit or loss had a contractual residual maturity of greater than one year.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2009 was £5,866 million (2008: £6,517 million), which was £294 million lower than the balance sheet carrying value (2008: £231 million). At 31 December 2009 there was a cumulative £55 million decrease in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of the Bank. Of the £55 million, £11 million arose in 2009 and £36 million arose in 2008.

Liabilities designated at fair value through profit or loss represent debt securities in issue which either contain substantive embedded derivatives which would otherwise need to be recognised and measured at fair value separately from the related debt securities, or which are accounted for at fair value to significantly reduce an accounting mismatch.

32 Debt securities in issue

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Medium-term notes issued	**47,786**	9,179	**47,791**	9,178
Certificates of deposit issued	**44,508**	33,207	**44,494**	33,060
Securitisation notes (see note 17)	**6,563**	10,050	**3,404**	24,457
Commercial paper	**21,862**	20,630	**14,181**	7,864
Total debt securities in issue	**120,719**	73,066	**109,870**	74,559

At 31 December 2009 £52,690 million (2008: £16,121 million) of debt securities in issue of the Group and £49,554 million (2008: £26,231 million) of the Bank had a contractual residual maturity of greater than one year.

33 Liabilities of the Group arising from insurance contracts and participating investment contracts

Insurance contract and participating investment contract liabilities are comprised as follows:

	2009			2008		
	Gross £m	**Re-insurance[1] £m**	**Net £m**	Gross £m	Re-insurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	**24,077**	**(405)**	**23,672**	21,553	(380)	21,173
Participating investment contracts	**12,273**	**–**	**12,273**	11,619	–	11,619
	36,350	**(405)**	**35,945**	33,172	(380)	32,792
Non-life insurance contracts (see (2) below):						
Unearned premiums	**387**	**(11)**	**376**	472	–	472
Claims outstanding	**223**	**(3)**	**220**	183	(5)	178
	610	**(14)**	**596**	655	(5)	650
	36,960	**(419)**	**36,541**	33,827	(385)	33,442

[1] Reinsurance balances are reported within other assets (note 28).

At 31 December 2009 £33,303 million (2008: £30,002 million) of liabilities arising from insurance contracts and participating investment contracts had a contractual residual maturity of greater than one year.

33 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

(1) Life insurance

The movement in life insurance contract and participating investment contract liabilities over the year can be analysed as follows:

	Insurance contracts	Participating investment contracts	Gross £m	Reinsurance £m	Net £m
At 1 January 2008	22,655	14,874	37,529	(340)	37,189
New business	2,915	208	3,123	(32)	3,091
Changes in existing business	(4,017)	(3,463)	(7,480)	(8)	(7,488)
Change in liabilities charged to the income statement (note 9)	(1,102)	(3,255)	(4,357)	(40)	(4,397)
At 31 December 2008	**21,553**	**11,619**	**33,172**	**(380)**	**32,792**
New business	**2,182**	**98**	**2,280**	**(27)**	**2,253**
Changes in existing business	**342**	**556**	**898**	**2**	**900**
Change in liabilities charged to the income statement (note 9)	**2,524**	**654**	**3,178**	**(25)**	**3,153**
At 31 December 2009	**24,077**	**12,273**	**36,350**	**(405)**	**35,945**

Liabilities for life insurance contracts and participating investment contracts can be split into with-profit fund liabilities, accounted for using the FSA's realistic capital regime (realistic liabilities) and non-profit fund liabilities, accounted for using a prospective actuarial discounted cash flow methodology, as follows:

	2009			2008		
	With-profit fund £m	**Non-profit fund £m**	**Total £m**	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	**7,641**	**16,436**	**24,077**	7,492	14,061	21,553
Participating investment contracts	**5,720**	**6,553**	**12,273**	5,836	5,783	11,619
	13,361	**22,989**	**36,350**	13,328	19,844	33,172

With-profit fund realistic liabilities

(i) ***Business description***

The Group has with-profit funds within Scottish Widows plc containing both insurance contracts and participating investment contracts.

The primary purpose of the conventional and unitised business written in the with-profit funds is to provide a long-term smoothed investment vehicle to the policyholders, protecting them against short-term market fluctuations. With-profit policyholders are entitled to at least 90 per cent of the distributed profits, the shareholders receiving the balance. The policyholder is also usually insured against death and the policy may carry a guaranteed annuity option at maturity.

(ii) ***Method of calculation of liabilities***

With-profit liabilities are stated at their realistic value, the main components of which are:

- With-profit benefit reserve, i.e. the total asset shares for with-profit policies;
- Cost of options and guarantees
- Deductions levied against asset shares; and
- Impact of the smoothing policy.

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market consistent basis. The calculation of realistic liabilities uses best estimate assumptions for mortality, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 24.

(iii) ***Assumptions***

Key assumptions used in the calculation of with-profit liabilities, and the processes for determining these, are:

Investment returns and discount rates

The realistic capital regime dictates that with-profit fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The with-profit fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as the spot yield derived from the relevant government bond yield curve.

Guaranteed annuity options

Certain pension contracts contain guaranteed annuity options that allow the policyholder to take an annuity benefit on retirement at annuity rates that were guaranteed at the outset of the contract. For contracts that contain such options, key assumptions in determining the costs of the options are economic conditions in which the option has value, mortality rates and take-up rates of the options. The financial impact is dependent on the value of corresponding investments, interest rates and longevity at the time of the claim.

Investment volatility

The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical volatility where it is not possible to observe meaningful prices.

33 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

Mortality
The mortality assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.

Lapse rates (persistency)
Lapse rates refer to the rate of policy termination or the rate at which policyholders stop paying regular premiums due under the contract.

Historical persistency experience is analysed using statistical techniques. As experience can vary considerably between different product types and for contracts that have been in force for different periods, the data is broken down into broadly homogenous groups for the purposes of this analysis.

The most recent experience is considered along with the results of previous analyses and management's views on future experience, taking into consideration potential changes in future experience that may result from guarantees and options becoming more valuable under adverse market conditions, in order to determine a 'best estimate' view of what persistency will be. In determining this best estimate view a number of factors are considered, including the credibility of the results (which will be affected by the volume of data available), any exceptional events that have occurred during the period under consideration, any known or expected trends in underlying data and relevant published market data.

Non-profit fund liabilities
(i) ***Business description***
The Group principally writes the following types of life insurance contracts within its non-profit funds. Shareholder profits on this type of business arise from management fees and other policy charges.

Unit-linked business – This includes unit-linked pensions and unit-linked bonds, the primary purpose of which is to provide an investment vehicle where the policyholder is also insured against death.

Life insurance – The policyholder is insured against death or permanent disability, usually for predetermined amounts. Such business includes whole-of-life and term assurance and long-term creditor policies.

Annuities – The policyholder is entitled to payments for the duration of their life and is therefore insured against surviving longer than expected.

(ii) ***Method of Calculation of liabilities***
The non-profit fund liabilities are determined on the basis of recognised actuarial methods and consistent with the approach required by regulatory rules. The methods used involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting the cash flows back to the valuation date allowing for probabilities of occurrence.

(iii) ***Assumptions***
Generally, assumptions used to value non-profit fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of non-profit fund liabilities are:

Interest rates
The rates used are derived in accordance with the guidelines set by local regulatory bodies. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the guidelines set by local regulatory bodies, including reductions made to the available yields to allow for default risk based upon the credit rating of the securities allocated to the insurance liability.

Mortality and morbidity
The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and include a margin for adverse deviation.

Lapse rates (persistency)
Lapse rates are allowed for on some non-profit fund contracts. The process for setting these rates is as described for with-profit liabilities, however a prudent scenario is assumed by the inclusion of a margin for adverse deviation within the non-profit fund liabilities.

Maintenance expenses
Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation. Explicit allowance is made for future expense inflation.

Key changes in assumptions
A detailed review of the Group's assumptions in 2009 resulted in the following key impacts on profit before tax:

– Change in persistency assumptions (£66 million decrease)

– Change in the key assumption in respect of future mortality rates (£2 million increase)

These amounts include the impacts of movements in liabilities and value of the in-force business in respect of insurance contracts and participating investment contracts.

33 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

(2) Non-life insurance

Gross non-life insurance contract liabilities are analysed by line of business as follows:

	2009 £m	2008 £m
Credit protection	**228**	293
Home	**379**	359
Health	**3**	3
	610	655

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. There has been no significant change in the assumptions and methodologies used for setting reserves.

The reserving methodology and associated assumptions are set out below:

The unearned premium reserve is determined on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of each contract.

Claims outstanding comprise those claims that have been notified and those that have been incurred but not reported. Claims incurred but not reported are determined based on the historical emergence of claims and their average cost. The notified claims element represents the best estimate of the cost of claims reported using projections and estimates based on historical experience.

The movements in non-life insurance contract liabilities and reinsurance assets over the year have been as follows:

Provisions for unearned premiums	Gross £m	Reinsurance £m	Net £m
At 1 January 2008	456	–	456
Increase in the year	651	(23)	628
Release in the year	(635)	23	(612)
Change in provision for unearned premiums charged to income statement (note 7)	16	–	16
At 31 December 2008	**472**	**–**	**472**
Increase in the year	**596**	**(34)**	**562**
Release in the year	**(681)**	**23**	**(658)**
Change in provision for unearned premiums charged to income statement (note 7)	**(85)**	**(11)**	**(96)**
At 31 December 2009	**387**	**(11)**	**376**

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

Claims and loss adjustment expenses	Gross £m	Reinsurance £m	Net £m
Notified claims	188	(10)	178
Incurred but not reported	19	–	19
At 1 January 2008	207	(10)	197
Cash paid for claims settled in the year	(245)	7	(238)
Increase (decrease) in liabilities:			
Arising from current year claims	221	–	221
Arising from prior year claims	–	(2)	(2)
Change in liabilities charged to income statement (note 9)	(24)	5	(19)
At 31 December 2008	**183**	**(5)**	**178**
Cash paid for claims settled in the year	**(234)**	**2**	**(232)**
Increase (decrease) in liabilities:			
Arising from current year claims	**287**	**–**	**287**
Arising from prior year claims	**(13)**	**–**	**(13)**
Change in liabilities charged to income statement (note 9)	**40**	**2**	**42**
At 31 December 2009	**223**	**(3)**	**220**
Notified claims	**165**	**(3)**	**162**
Incurred but not reported	**58**	**–**	**58**
At 31 December 2009	**223**	**(3)**	**220**
Notified claims	160	(5)	155
Incurred but not reported	23	–	23
At 31 December 2008	183	(5)	178

33 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

Non-life insurance claims development table
The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Group's estimate of total claims outstanding for each accident year has changed at successive year ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. The accident year basis is considered the most appropriate for the business written by the Group.

Non-life insurance all risks – gross	Accident year					
	2005 £m	2006 £m	2007 £m	2008 £m	**2009 £m**	Total £m
Estimate of ultimate claims costs:						
At end of accident year	211	208	317	205	**262**	**1,203**
One year later	207	206	311	199		
Two years later	204	204	299			
Three years later	202	204				
Four years later	201					
Current estimate of cumulative claims	**201**	**204**	**299**	**199**	**262**	**1,165**
Cumulative payments to date	**(198)**	**(198)**	**(278)**	**(171)**	**(114)**	**(959)**
Liability recognised in the balance sheet	**3**	**6**	**21**	**28**	**148**	**206**
Liability in respect of earlier years						**7**
Total liability included in the balance sheet						**213**

The liability of £213 million shown in the above table excludes £10 million of unallocated claims handling expenses.

34 Insurance sensitivity analysis of the Group
The following table demonstrates the effect of changes in key assumptions on profit before tax and equity disclosed in these financial statements assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in assets, liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts. The impact is shown in one direction but can be assumed to be reasonably symmetrical.

	Change in variable	Increase/(reduction) in profit before tax £m	Increase/(reduction) in equity £m
Non-annuitant mortality[1]	**5% reduction**	**26**	**19**
Annuitant mortality[2]	**5% reduction**	**(82)**	**(59)**
Lapse rates[3]	**10% reduction**	**39**	**28**
Future maintenance and investment expenses[4]	**10% reduction**	**96**	**69**
Risk-free rate[5]	**0.25% reduction**	**48**	**35**
Guaranteed annuity option take-up[6]	**5% addition**	**(5)**	**(3)**
Equity investment volatility[7]	**1% addition**	**(9)**	**(6)**
Widening of credit default spreads on corporate bonds[8]	**0.25% addition**	**(105)**	**(76)**
Increase in illiquidity premia[9]	**0.10% addition**	**56**	**41**

Assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases.

[1]This sensitivity shows the impact of reducing mortality and morbidity rates on non-annuity business to 95 per cent of the expected rate.

[2]This sensitivity shows the impact on the annuity and deferred annuity business of reducing mortality rates to 95 per cent of the expected rate.

[3]This sensitivity shows the impact of reducing lapse and surrender rates to 90 per cent of the expected rate.

[4]This sensitivity shows the impact of reducing maintenance expenses and investment expenses to 90 per cent of the expected rate.

[5]This sensitivity shows the impact on the value of in-force business, financial options and guarantee costs, statutory reserves and asset values of reducing the risk-free rate by 25 basis points.

[6]This sensitivity shows the impact of a flat 5 per cent addition to the expected rate.

[7]This sensitivity shows the impact of a flat 1 per cent addition to the expected rate.

[8]This sensitivity shows the impact of a 25 basis point increase in credit default spreads on corporate bonds and the corresponding reduction in market values. Government bond yields, the non-annuity risk-free rate and illiquidity premia are all assumed to be unchanged.

[9]This sensitivity shows the impact of a 10 basis point increase in the allowance for illiquidity premia. It assumes the overall corporate bond spreads are unchanged and hence market values are unchanged. Government bond yields and the risk-free rate are both assumed to be unchanged. The increased illiquidity premium increases the annuity risk-free rate.

35 Liabilities of the Group arising from non-participating investment contracts

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

	Gross £m	Reinsurance £m	Net £m
At 1 January 2008	18,197	–	18,197
New business	660	–	660
Changes in existing business	(4,614)	–	(4,614)
At 31 December 2008	**14,243**	–	**14,243**
New business	**242**	–	**242**
Changes in existing business	**1,249**	–	**1,249**
At 31 December 2009	**15,734**	**–**	**15,734**

36 Unallocated surplus within insurance businesses for the Group

The movement in the unallocated surplus within long-term insurance business over the year can be analysed as follows:

	2009 £m	2008 £m
At 1 January	**270**	554
Change in unallocated surplus recognised in the income statement (note 9)	**40**	(284)
At 31 December	**310**	270

37 Other liabilities

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Settlement balances	**361**	891	**101**	548
Unitholders' interest in Open Ended Investment Companies	**5,908**	4,336	**–**	–
Other creditors and accruals	**5,994**	6,267	**3,336**	4,407
	12,263	11,494	**3,437**	4,955

At 31 December 2009 £7,796 million (2008: £5,481 million) of other liabilities of the Group and £1,032 million (2008: £56 million) of the Bank had a contractual residual maturity of greater than one year.

38 Retirement benefit obligations

Charge to the Group income statement:

	2009 £m	2008 £m
Defined benefit pension schemes	**267**	157
Other post-retirement benefit schemes	**7**	7
Total defined benefit schemes	**274**	164
Defined contribution pension schemes	**88**	71
	362	235

Amounts recognised in the balance sheet:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Defined benefit pension schemes	**360**	1,657	**17**	1,240
Other post-retirement benefit schemes	**114**	114	**114**	114
	474	1,771	**131**	1,354

For accounting purposes, the assets and liabilities of the Group's post-retirement benefit schemes are allocated between the participating employers, including the Bank, in proportion to the cash contributions made to the schemes.

38 Retirement benefit obligations (continued)

Pension schemes

Defined benefit schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas, the most significant being the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2. These schemes provide retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes is 50.

The latest full valuations of the two main schemes were carried out as at 30 June 2008. The provisional results have been updated to 31 December 2009 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2009 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The Group's and the Bank's obligations in respect of defined benefit schemes are funded. During 2009, the Group's contributions to its defined benefit schemes of £1,567 million included one-off contributions to the Lloyds TSB Group Pension Scheme No 1 and Lloyds TSB Group Pension Scheme No 2 of approximately £1 billion in aggregate. These contributions took the form of interests in limited liability partnerships for each of the two schemes which contain assets of approximately £5 billion in aggregate entitling the schemes to annual payments of approximately £215 million in aggregate until 31 December 2014. Thereafter, assuming that all distributions have been made, the value of the partnership interests will equate to a nominal amount. The limited liability partnerships are fully consolidated in the Group's balance sheet (see note 18).

The Group currently expects to pay contributions of at least £260 million (the Bank: at least £190 million) to its defined benefit schemes in 2010.

Amounts included in the balance sheet:	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Present value of funded obligations	**18,796**	15,617	**14,363**	12,015
Fair value of scheme assets	**(16,075)**	(13,693)	**(12,507)**	(10,488)
	2,721	1,924	**1,856**	1,527
Unrecognised actuarial losses	**(2,361)**	(267)	**(1,839)**	(287)
Liability in the balance sheet	**360**	1,657	**17**	1,240

Movements in the defined benefit obligation:	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
At 1 January	**15,617**	16,795	**12,015**	12,899
Current service cost	**216**	258	**158**	188
Interest cost	**956**	957	**732**	747
Actuarial losses (gains)	**2,649**	(1,928)	**1,938**	(1,476)
Benefits paid	**(647)**	(597)	**(494)**	(470)
Past service cost	**31**	21	**26**	22
Curtailments	**–**	6	**–**	–
Exchange and other adjustments	**(26)**	105	**(12)**	105
At 31 December	**18,796**	15,617	**14,363**	12,015

Changes in the fair value of scheme assets:	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
At 1 January	**13,693**	16,112	**10,488**	12,410
Expected return	**936**	1,085	**720**	835
Employer contributions	**1,567**	541	**1,419**	403
Actuarial gains (losses)	**542**	(3,520)	**376**	(2,762)
Benefits paid	**(647)**	(597)	**(494)**	(470)
Exchange and other adjustments	**(16)**	72	**(2)**	72
At 31 December	**16,075**	13,693	**12,507**	10,488
Actual return on scheme assets	**1,478**	(2,435)	**1,096**	(1,927)

38 Retirement benefit obligations (continued)

Assumptions

The principal actuarial and financial assumptions used in the valuations of the defined benefit pension schemes were as follows:

	2009 **%**	2008 %
Discount rate	**5.70**	6.30
Rate of inflation	**3.40**	3.00
Rate of salary increases	**3.75**	3.75
Rate of increase for pensions in payment	**3.20**	2.80
	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.1**	26.4
Women	**28.2**	27.2
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.7**	27.3
Women	**29.8**	28.1

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2009 is assumed to live for, on average, 27.1 years for a male and 28.2 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

An analysis of the impact of a reasonable change in these assumptions is provided in note 3.

The expected return on scheme assets has been calculated using the following assumptions:	**2009** **%**	2008 %
Equities	**8.4**	8.2
Fixed interest gilts	**3.7**	4.5
Index linked gilts	**4.0**	4.4
Non-Government bonds	**6.7**	6.0
Property	**6.4**	6.7
Money market instruments and cash	**3.8**	4.8

The expected return on scheme assets in 2010 will be calculated using the following assumptions:	**2010** **%**
Equities and alternative assets	**8.3**
Fixed interest gilts	**4.5**
Index linked gilts	**4.1**
Non-Government bonds	**6.0**
Property	**7.5**
Money market instruments and cash	**4.3**

Composition of scheme assets:	The Group		The Bank	
	2009 **£m**	2008 £m	**2009** **£m**	2008 £m
Equities	**7,689**	7,040	**5,932**	5,404
Fixed interest gilts	**1,327**	1,452	**1,071**	1,157
Index linked gilts	**1,510**	1,326	**1,007**	890
Non-Government bonds	**1,917**	1,721	**1,491**	1,323
Property	**1,391**	1,485	**1,129**	1,192
Money market instruments, cash and other assets and liabilities	**2,241**	669	**1,877**	522
At 31 December	**16,075**	13,693	**12,507**	10,488

The assets of all the funded plans are held independently of the Group's assets in separate trustee administered funds.

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields at the balance sheet date at a term and credit rating broadly appropriate for the bonds held. Expected returns on equity and property investment are long-term rates based on the views of the plans' independent investment consultants. The expected return on equities allows for the different expected returns from the private equity, infrastructure and hedge fund investments held by some of the funded plans. Some of the funded plans also invest in certain money market instruments and the expected return on these investments has been assumed to be the same as cash.

38 Retirement benefit obligations (continued)

Experience adjustments history

The Group	**2009 £m**	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligation	**18,796**	15,617	16,795	17,378	17,320
Fair value of scheme assets	**(16,075)**	(13,693)	(16,112)	(15,279)	(14,026)
	2,721	1,924	683	2,099	3,294
Experience losses on scheme liabilities	**(14)**	(39)	(185)	(50)	(69)
Experience gains (losses) on scheme assets	**542**	(3,520)	139	314	1,538

The Bank	**2009 £m**	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligation	**14,363**	12,015	12,899	13,166	13,134
Fair value of scheme assets	**(12,507)**	(10,488)	(12,410)	(11,579)	(10,619)
	1,856	1,527	489	1,587	2,515
Experience losses on scheme liabilities	**(4)**	(23)	(150)	(42)	(53)
Experience gains (losses) on scheme assets	**377**	(2,750)	114	243	1,166

The expense recognised in the consolidated income statement for the year ended 31 December comprises:	**2009 £m**	2008 £m
Current service cost	**216**	258
Interest cost	**956**	957
Expected return on scheme assets	**(936)**	(1,085)
Curtailments	**–**	6
Past service cost	**31**	21
Total defined benefit pension expense	**267**	157

Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2.

During the year ended 31 December 2009 the charge to the income statement in respect of these schemes was £88 million (2008: £71 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

The Group operates a number of schemes which provide post-retirement healthcare benefits and concessionary mortgages to certain employees, retired employees and their dependants. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependants) who retired prior to 1 January 1996. The Group has entered into an insurance contract to provide these benefits and a provision has been made for the estimated cost of future insurance premiums payable.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2008; this valuation has been updated to 31 December 2009 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7.33 per cent (2008: 7.50 per cent).

Amount included in the balance sheet:	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Present value of unfunded obligations	**120**	118	**120**	118
Unrecognised actuarial losses	**(6)**	(4)	**(6)**	(4)
Liability in the balance sheet	**114**	114	**114**	114

38 Retirement benefit obligations (continued)

Movements in the other post-retirement benefits obligation:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
At 1 January	**118**	123	**118**	123
Exchange and other adjustments	**(1)**	2	**(1)**	2
Actuarial loss (gain)	**2**	(8)	**2**	(8)
Insurance premiums paid	**(6)**	(6)	**(6)**	(6)
Charge for the year	**7**	7	**7**	7
At 31 December	**120**	118	**120**	118

39 Deferred tax balances

The movement in the net deferred tax balance is as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Asset (liability) at 1 January	**837**	(949)	**1,161**	619
Exchange and other adjustments	**1**	(1)	**–**	(1)
Disposals	**12**	96	**–**	–
Income statement credit (note 12)	**2,146**	762	**1,475**	538
Amount credited (charged) to equity:				
Available-for-sale financial assets (note 44)	**(206)**	566	**30**	–
Net investment hedges (note 44)	**(358)**	358	**–**	–
Cash flow hedges (note 44)	**6**	5	**6**	5
	(558)	929	**36**	5
Asset at 31 December	**2,438**	837	**2,672**	1,161

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated balance sheet and takes account of the inability to offset assets and liabilities where there is no legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the table below which splits the deferred tax assets and liabilities by type.

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Statutory position				
Deferred tax asset	**2,438**	837	**2,672**	1,161
Deferred tax liabilities	**–**	–	**–**	–
Net deferred tax asset	**2,438**	837	**2,672**	1,161
Tax disclosure				
Deferred tax asset	**3,420**	2,293	**2,723**	1,181
Deferred tax liabilities	**(982)**	(1,456)	**(51)**	(20)
Net deferred tax asset	**2,438**	837	**2,672**	1,161

The deferred tax credit in the consolidated income statement comprises the following temporary differences:

	2009 £m	2008 £m
Accelerated capital allowances	**492**	318
Pensions and other post-retirement benefits	**(191)**	(118)
Investment reserve	**9**	(32)
Allowances for impairment losses	**(15)**	2
Unrealised gains	**59**	387
Tax on value of in-force business	**(160)**	193
Trading losses	**1,810**	97
Other temporary differences	**142**	(85)
	2,146	762

39 Deferred tax balances (continued)

Deferred tax assets and liabilities are comprised as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deferred tax assets:				
Pensions and other post-retirement benefits	**311**	503	**225**	364
Allowances for impairment losses	**88**	103	**85**	99
Other provisions	**159**	51	**155**	38
Derivatives	**91**	99	**97**	85
Available-for-sale asset revaluation	**324**	567	**–**	–
Tax losses carried forward	**2,316**	856	**1,970**	476
Accelerated capital allowances	**–**	–	**158**	78
Other temporary differences	**131**	114	**33**	41
	3,420	2,293	**2,723**	1,181
Deferred tax liabilities:				
Accelerated capital allowances	**(56)**	(561)	**–**	–
Investment reserve	**(142)**	(151)	**–**	–
Unrealised gains	**–**	(45)	**–**	–
Tax on value of in-force business	**(618)**	(459)	**–**	–
Other temporary differences	**(166)**	(240)	**(51)**	(20)
	(982)	(1,456)	**(51)**	(20)

Deferred tax assets

Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable. Group companies have recognised deferred tax assets of £2,316 million (2008: £856 million) in relation to tax losses carried forward. After reviews of medium-term profit forecasts, the Group considers that there will be sufficient profits in the future against which these losses will be offset.

Deferred tax assets of £91 million for the Group and £55 million for the Bank (2008: £252 million for the Group and £55 million for the Bank) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of unrelieved foreign tax carried forward as at 31 December 2009 of £13 million for the Group and the Bank (2008: £60 million for the Group and £12 million for the Bank), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. These tax credits can be carried forward indefinitely.

Deferred tax liabilities

Future transfers from Scottish Widows plc's long-term business funds to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £90 million (2008: £90 million) have not been recognised.

Scottish Widows plc has a taxable difference of £152 million (2008: 152 million) in repect of its holding of a life insurance subsidiary. No deferred tax liability is required to be recognised in respect of this taxable temporary difference under IAS 12 as Scottish Widows plc does not intend to dispose of this subsidiary company.

40 Other provisions

The Group	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Restructuring provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2009	**30**	**34**	**14**	**28**	**124**	**230**
Exchange and other adjustments	**(1)**	**1**	**–**	**–**	**6**	**6**
Transfers	**–**	**157**	**–**	**–**	**–**	**157**
Provisions applied	**–**	**(5)**	**(1)**	**(10)**	**(2)**	**(18)**
Amortisation of discount	**–**	**–**	**–**	**2**	**–**	**2**
Charge for the year	**38**	**(1)**	**101**	**18**	**14**	**170**
At 31 December 2009	**67**	**186**	**114**	**38**	**142**	**547**

40 Other provisions (continued)

The Bank	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Restructuring provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2009	**54**	**31**	**14**	**27**	**80**	**206**
Exchange and other adjustments	**–**	**1**	**–**	**–**	**10**	**11**
Transfers	**–**	**157**	**–**	**–**	**–**	**157**
Provisions applied	**–**	**(4)**	**(1)**	**(9)**	**(1)**	**(15)**
Amortisation of discount	**–**	**–**	**–**	**2**	–	**2**
Charge for the year	**42**	**(1)**	**101**	**18**	**12**	**172**
At 31 December 2009	**96**	**184**	**114**	**38**	**101**	**533**

Provisions for contingent liabilities and commitments
Provisions are held in cases where the Group is irrevocably committed to advance additional funds, but where there is doubt as to the customer's ability to meet its repayment obligations.

Customer remediation provisions
The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2009 management has reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and are satisfied that no additional charge is required. At 31 December 2009 the remaining provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks.

Restructuring
Provisions are made for staff and other costs related to Group structuring initiatives at the point at which the Group becomes irrevocably committed to the expenditure.

Vacant leasehold property
Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a biennial basis and will normally run-off over the period of under-recovery of the leases concerned, currently averaging five years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Other
Included within other are provisions which the Group carries in respect of its obligations relating to UIC Insurance Company Limited (UIC), which is in provisional liquidation. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate cost of settling the Group's exposure in respect of the insurance business of UIC and the timing remains uncertain. The provision held represents management's current best estimate of the cost after having regard to the financial condition of UIC and actuarial estimates of future claims.

41 Subordinated liabilities

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Preferred securities	**4,029**	5,375	**4,029**	5,375
Undated subordinated liabilities	**5,782**	5,641	**5,235**	5,105
Dated subordinated liabilities	**6,188**	6,373	**6,192**	6,373
	15,999	17,389	**15,456**	16,853

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of the specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preferred shares and securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of the holders of the dated subordinated liabilities. Neither the Group nor the Bank has had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year (2008: none). No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the Financial Services Authority.

41 Subordinated liabilities (continued)

The Group

	Note	2009 £m	2008 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)		**645**	756
Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a	**565**	600
Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a	**590**	687
6% Non-cumulative Redeemable Preference Shares	b	**–**	–
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)		**428**	459
7.875% Fixed/Floating non-cumulative preference shares (€500 million)		**146**	472
7.875% Fixed/Floating non-cumulative preference shares (US$1,250 million)		**246**	921
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)		**456**	512
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)		**248**	248
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)		**705**	720
		4,029	5,375
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:			
Series 1 (US$750 million)		**408**	515
Series 2 (US$500 million)		**262**	343
Series 3 (US$600 million)		**326**	412
11¾% Perpetual Subordinated Bonds (£100 million)		**102**	100
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)		**–**	1,212
Undated Step-up Floating Rate Notes callable 2009 (€150 million)		**–**	144
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)		**157**	409
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million) (Scottish Widows plc)	d	**547**	536
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)		**165**	189
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		**140**	455
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)		**89**	241
13% Step-up Perpetual Capital Securities callable 2019 (£784 million)		**827**	–
13% Euro Step-up Perpetual Capital Securities callable 2019 (€532 million)		**510**	–
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)		**64**	186
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		**1,235**	–
13% Sterling Step-up Perpetual Capital Securities callable 2029 (£700 million)		**738**	–
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)		**103**	444
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)		**109**	455
		5,782	5,641
Dated subordinated liabilities			
9½% Subordinated Bonds 2009 (£100 million)		**–**	100
6¼% Subordinated Notes 2010 (€400 million)		**375**	404
12% Guaranteed Subordinated Bonds 2011 (£100 million)	c	**116**	107
4¾% Subordinated Notes 2011 (€850 million)		**771**	836
Subordinated Floating Rate Notes 2011 (£150 million)		**150**	150
Subordinated Floating Rate Notes 2011 (£100 million)		**100**	100
Subordinated Floating Rate Notes 2012 (£200 million)		**200**	200
Subordinated Floating Rate Notes 2013 (£150 million)		**150**	150
Subordinated Floating Rate Notes 2014 (£464 million)		**465**	464
5⅞% Subordinated Notes 2014 (£150 million)		**154**	149
6⅝% Subordinated Notes 2015 (£350 million)		**335**	320
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)		**296**	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)		**445**	480
Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		**979**	992
Subordinated Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)		**758**	754
Subordinated Floating Rate Notes 2020 (€100 million)		**89**	96
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		**322**	309
9⅝% Subordinated Bonds 2023 (£300 million)		**333**	312
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		**150**	150
		6,188	6,373
Total subordinated liabilities		**15,999**	17,389

At 31 December 2009 £15,624 million (2008: £17,289 million) of subordinated liabilities had a contractual residual maturity of greater than one year.

41 Subordinated liabilities (continued)

The Bank

	Note	**2009 £m**	2008 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)		**645**	756
Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)		**565**	600
Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)		**590**	687
6% Non-cumulative Redeemable Preference Shares		**–**	
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)		**428**	459
7.875% Fixed/Floating non-cumulative preference shares (€500 million)		**146**	472
7.875% Fixed/Floating non-cumulative preference shares (US$1,250 million)		**246**	921
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)		**456**	512
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)		**248**	248
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)		**705**	720
		4,029	5,375
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:			
Series 1 (US$750 million)		**408**	515
Series 2 (US$500 million)		**262**	343
Series 3 (US$600 million)		**326**	412
11¾% Perpetual Subordinated Bonds (£100 million)		**102**	100
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)		**–**	1,212
Undated Step-up Floating Rate Notes callable 2009 (€150 million)		**–**	144
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)		**157**	409
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)		**165**	189
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		**140**	455
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)		**89**	241
13% Step-up Perpetual Capital Securities callable 2019 (£784 million)		**827**	–
13% Euro Step-up Perpetual Capital Securities callable 2019 (€532 million)		**510**	–
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)		**64**	186
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		**1,235**	–
13% Sterling Step-up Perpetual Capital Securities callable 2029 (£700 million)		**738**	–
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)		**103**	444
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)		**109**	455
		5,235	5,105
Dated subordinated liabilities			
9½% Subordinated Bonds 2009 (£100 million)		**–**	100
6¼% Subordinated Notes 2010 (€400 million)		**375**	404
12% Guaranteed Subordinated Bonds 2011 (£100 million)		**116**	107
4¾% Subordinated Notes 2011 (€850 million)		**771**	836
Subordinated Floating Rate Notes 2011 (£150 million)		**150**	150
Subordinated Floating Rate Notes 2011 (£100 million)		**100**	100
Subordinated Floating Rate Notes 2012 (£200 million)		**200**	200
Subordinated Floating Rate Notes 2013 (£150 million)		**150**	150
Subordinated Floating Rate Notes 2014 (£464 million)		**465**	464
5⅞% Subordinated Notes 2014 (£150 million)		**154**	149
6⅝% Subordinated Notes 2015 (£350 million)		**335**	320
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)		**300**	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)		**445**	480
Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		**979**	992
Subordinated Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)		**758**	754
Subordinated Floating Rate Notes 2020 (€100 million)		**89**	96
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		**322**	309
9⅝% Subordinated Bonds 2023 (£300 million)		**333**	312
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		**150**	150
		6,192	6,373
Total subordinated liabilities		**15,456**	16,853

At 31 December 2009 £15,081 million (2008: £16,753 million) of subordinated liabilities had a contractual residual maturity of greater than one year.

a) In certain circumstances, these preference shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities. The Bank may declare no dividend or a partial dividend on these preference shares. Dividends may be reduced if the distributable profits of the Bank are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Bank.

b) Since 2004, the Bank has had in issue 100 6 per cent non-cumulative redeemable preference shares of £1 each. The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Bank. The holder of the 100 £1 6 per cent preference shares has waived its rights to payment for the period from 1st March 2010 to 1st March 2012.

41 Subordinated liabilities (continued)

c) Guaranteed by Lloyds Banking Group plc on a subordinated basis.
d) Scottish Widows plc may elect to defer interest on these securities although in that event Scottish Widows plc cannot declare or pay a dividend on any ordinary share capital until any deferred payments have been made.

42 Share capital

(1) Authorised share capital

	Group and Bank	
	2009 £m	2008 £m
Sterling		
1,650 million ordinary shares of £1 each	**1,650**	1,650
1 cumulative floating rate Preference share of £1	**–**	–
100 6 per cent Non-Cumulative Redeemable Preference shares of £1 each	**–**	–
175 million Preference shares of 25p each	**44**	44
	1,694	1,694
US dollars	**US$m**	US$m
160 million Preference shares of 25 cents each	**40**	40
Euro	**€m**	€m
160 million Preference shares of 25 cents each	**40**	40
Japanese yen	**¥m**	¥m
50 million Preference shares of ¥25 each	**1,250**	1,250

	2009 Number of shares	2008 Number of shares	**2009 £m**	2008 £m
(2) Issued and fully paid ordinary shares				
Sterling				
Ordinary shares of £1 each				
At 1 January	**1,541,680,932**	1,541,680,932	**1,542**	1,542
Issued in the year	**5,600,000**	–	**5**	–
At 31 December	**1,547,280,932**	1,541,680,932	**1,547**	1,542

Issue of ordinary shares
On 14 December 2009, the Bank issued 5.6 million ordinary shares to its ultimate parent undertaking for a total consideration of £5,600 million; these shares were issued in order to maintain the Bank's capital following payment of the Government Asset Protection Scheme fee and the subvention payment (note 10).

Issued and fully paid preference shares
The Bank has in issue various classes of preference shares which are all classified as liabilities under IFRS and details of which are shown in note 41.

43 Share premium account

	Group and Bank	
	2009 £m	2008 £m
At 1 January and 31 December	**2,960**	2,960
Premium arising on shares issued in the year (see note 42)	**5,595**	–
At 31 December	**8,555**	2,960

44 Other reserves

Other reserves comprise:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Revaluation reserve in respect of available-for-sale financial assets	**(1,572)**	(2,982)	**(399)**	(361)
Cash flow hedging reserve	**(30)**	(15)	**(30)**	(15)
Foreign currency translation reserve	**129**	173	**99**	127
	(1,473)	(2,824)	**(330)**	(249)

Movements in other reserves were as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Revaluation reserve in respect of available-for-sale financial assets:				
At 1 January	**(2,982)**	(399)	**(361)**	(49)
Exchange and other adjustments	**175**	(541)	**17**	(85)
Change in fair value of available-for-sale financial assets	**1,430**	(2,721)	**(41)**	(335)
Change in fair value attributable to minority interests	**(1)**	2	**–**	–
Deferred tax	**(206)**	566	**20**	–
Current tax	**(2)**	94	**–**	91
	1,221	(2,059)	**(21)**	(244)
Income statement transfers:				
Disposals (see note 8)	**(1)**	(19)	**(1)**	(19)
Deferred tax	**(2)**	–	**(2)**	–
	(3)	(19)	**(3)**	(19)
Impairment	**44**	130	**15**	130
Deferred tax	**(6)**	–	**(4)**	–
Current tax	**–**	(28)	**–**	(28)
	38	102	**11**	102
Other transfers	**(29)**	(91)	**(58)**	(91)
Deferred tax	**8**	–	**16**	–
Current tax	**–**	25	**–**	25
	(21)	(66)	**(42)**	(66)
At 31 December	**(1,572)**	(2,982)	**(399)**	(361)
Cash flow hedging reserve:				
At 1 January	**(15)**	(3)	**(15)**	(3)
Change in fair value of hedging derivatives	**(4)**	(33)	**(4)**	(33)
Deferred tax	**1**	9	**1**	9
	(3)	(24)	**(3)**	(24)
Income statement transfer (note 4)	**(17)**	16	**(17)**	16
Deferred tax	**5**	(4)	**5**	(4)
	(12)	12	**(12)**	12
At 31 December	**(30)**	(15)	**(30)**	(15)
Foreign currency translation reserve:				
At 1 January	**173**	(9)	**127**	8
Currency translation differences arising in the year	**(676)**	2,536	**(28)**	119
Foreign currency losses on net investment hedges	**814**	(3,310)	**–**	–
Amounts transferred to the income statement in respect of hedge ineffectiveness	**–**	14	**–**	–
Current tax	**176**	584	**–**	–
Deferred tax	**(358)**	358	**–**	–
	632	(2,354)	**–**	–
At 31 December	**129**	173	**99**	127

45 Retained profits

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
At 1 January	**7,588**	9,064	**2,960**	5,672
Profit (loss) for the year*	**(2,797)**	818	**(1,909)**	(418)
Dividends	**–**	(2,294)	**–**	(2,294)
At 31 December	**4,791**	7,588	**1,051**	2,960

*No income statement has been shown for the Bank, as permitted by Section 408 of the Companies Act 2006.

46 Ordinary dividends

	2009 £m	2008 £m
Final dividend for previous year paid during the current year	**–**	1,646
Interim dividend	**–**	648
	–	2,294

47 Share based payments

Charge to the income statement
The charge to the income statement is set out below:

	2009 £m	2008 £m
Deferred bonus scheme	**18**	–
Executive and SAYE schemes:		
Options granted in the year	**13**	28
Options granted in prior years	**61**	31
	74	59
Share incentive plan:		
Shares granted in the year	**3**	10
Shares granted in prior years	**14**	21
	17	31
	109	90

Share based payment scheme details
During the year ended 31 December 2009 Lloyds Banking Group plc operated the following share based payment schemes for which employees of the Lloyds TSB Bank Group were eligible and all of which are equity settled.

Executive schemes
The executive share option schemes were long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in August 2005. These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

47 Share based payments (continued)

Performance conditions for executive options

For options granted up to March 2001

Options granted	Performance conditions
March 1999 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking Group plc's ranking based on shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1999 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1999 and March 2001, the relevant period for the performance conditions began at the end of the financial year preceding the date of grant and continued until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions were met. Once the conditions were satisfied the options remain exercisable without further conditions. If they were not satisfied by the tenth anniversary of the grant the options would lapse.

For options granted from August 2001 to August 2004

The performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc.

The performance condition was measured over a three year which commenced at the end of the financial year preceding the grant of the option and continued until the end of the third subsequent year. If the performance condition was not then met, it was measured at the end of the fourth financial year. If the condition was not then met, the options would lapse.

To meet the performance conditions, Lloyds Banking Group plc's ranking against the comparator group was required to be at least ninth. The full grant of options only became exercisable if Lloyds Banking Group plc was ranked first. A performance multiplier (of between nil and 100 per cent) was applied below this level to calculate the number of shares in respect of which options granted to executive directors would become exercisable, and were calculated on a sliding scale. If Lloyds Banking Group plc was ranked below median the options would not be exercisable.

Options granted to senior executives other than executive directors were not so highly leveraged and, as a result, different performance multipliers were applied to their options. For the majority of executives, options were granted with the performance condition but with no performance multiplier.

Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 14 per cent for executive directors, 24 per cent for managing directors, and 100 per cent for all other executives.

For options granted in 2005

The same conditions applied as for grants made up to August 2004, except that:

– the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc;

– if the performance condition was not met at the end of the third subsequent year, the options would lapse; and

– the full grant of options became exercisable only if Lloyds Banking Group plc was ranked in the top four places of the comparator group. A sliding scale applied between fourth and eighth positions. If Lloyds Banking Group plc was ranked below the median (ninth or below) the options would lapse.

Options granted in 2005 became exercisable as the performance condition was met when tested. The performance condition vested at 82.5 per cent for all options granted.

Movements in the number of share options outstanding under the executive share option schemes during 2008 and 2009 are set out below:

	2009 Number of options	**2009 Weighted average exercise price (pence)**	2008 Number of options	2008 Weighted average exercise price (pence)
Outstanding at 1 January	**11,203,628**	**490.05**	20,621,774	480.57
Exercised	**–**	**–**	(137,431)	419.25
Forfeited	**(2,418,650)**	**536.46**	(9,280,715)	470.02
Outstanding at 31 December	**8,784,978**	**476.56**	11,203,628	490.05
Exercisable at 31 December	**8,784,978**	**476.56**	9,132,197	453.77

The weighted average share price at the time that the options were exercised during 2008 was 453.42 pence. The weighted average remaining contractual life of options outstanding at the end of the year was 4.3 years (2008: 5.1 years).

47 Share based payments (continued)

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £250 per month and, at the expiry of a fixed term of three, five or seven years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in Lloyds Banking Group plc at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

Movements in the number of share options outstanding under the SAYE schemes are set out below:

	2009 Number of options	**2009 Weighted average exercise price (pence)**	2008 Number of options	2008 Weighted average exercise price (pence)
Outstanding at 1 January	**190,478,449**	**152.54**	85,673,227	342.49
Granted	**–**	**–**	215,737,733	173.80
Exercised	**–**	**–**	(40,612,608)	290.77
Forfeited	**(4,436,478)**	**180.34**	(2,394,415)	388.11
Cancelled	**(68,822,665)**	**144.31**	(62,963,491)	373.21
Expired	**(5,063,534)**	**347.51**	(4,961,997)	311.47
Outstanding at 31 December	**112,155,772**	**147.69**	190,478,449	152.54
Exercisable at 31 December	**754,554**	**317.32**	3,157,524	332.12

The weighted average share price at the time that the options were exercised during 2008 was 370.29 pence. The weighted average remaining contractual life of options outstanding at the end of the year was 2.5 years (2008: 3.4 years).

The weighted average fair value of SAYE options granted during 2008 was £0.61. The values for the SAYE options have been determined using a standard Black-Scholes model.

Other share option plans

Lloyds TSB Group Executive Share Plan 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees. Options granted under this plan have been granted specifically to facilitate recruitment and as such were granted not subject to any performance conditions. The Plan has now been extended to not only compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes for within some instances the grant being made subject to individual performance conditions.

	2009 Number of options	**2009 Weighted average exercise price (pence)**	2008 Number of options	2008 Weighted average exercise price (pence)
Outstanding at 1 January	**857,611**	**Nil**	308,718	Nil
Granted	**24,704,070**	**Nil**	681,931	Nil
Rebasement adjustment	**1,876,005**	**Nil**	–	Nil
Exercised	**(157,105)**	**Nil**	(117,236)	Nil
Forfeited	**(1,181,396)**	**Nil**	(15,802)	Nil
Outstanding at 31 December	**26,099,185**	**Nil**	857,611	Nil
Exercisable at 31 December	**33,794**	**Nil**	–	Nil

The weighted average fair value of options granted in the year was £0.68 (2008: £2.92). The weighted average share price at the time that the options were exercised during 2009 was £0.71 (2008: £2.91). The weighted average remaining contractual life of options outstanding at the end of the year was 3.0 years (2008: 2.5 years).

The award was adjusted on 2 July 2009 as a result of the Placing and Compensatory Open Offer. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising event.

Other share plans

Long-Term Incentive Plan

The Long-Term Incentive Plan introduced in 2006 is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Lloyds Banking Group over a three year period. Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

The performance conditions for awards made in May and August 2006 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of Lloyds Banking Group plc (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Price Index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 per cent but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.

47 Share based payments (continued)

(ii) For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for Lloyds Banking Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where Lloyds Banking Group plc's total shareholder return is equal to median and vesting will occur on a straight line basis in between these points. Where Lloyds Banking Group plc's total shareholder return is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.

The performance conditions for awards made in March and August 2007 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009.

(ii) For the other 50 per cent of the award (the 'TSR Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of the first award) and ending on 7 March 2010.

The performance conditions for awards made in March, April, August and September 2008 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010.

(ii) For the other 50 per cent of the award (the 'TSR Award') – the performance condition is as described for May 2006, except that the comparator group comprises of 13 companies, with the relevant performance period commencing on 6 March 2008 (the date of the first award) and ending on 5 March 2011.

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances awards are made of 300 per cent of salary with the additional 100 per cent available for circumstances that the remuneration committee deems to be exceptional. In 2009, awards were made of 375 per cent of base salary to the chief executive and two of the executive directors for retention purposes, and in light of data reviewed by the committee which showed total remuneration to be behind median both for the FTSE 20, and the other major UK banks.

The performance conditions for awards made in April, May and September 2009 are as follows:

EPS: The release of 50 per cent of the shares will be dependent on the extent to which the growth in EPS achieves cumulative EPS targets over the three year period.

Economic profit: The release of the remaining 50 per cent of shares will be dependent on the extent to which Lloyds Banking Group achieves cumulative economic profit targets over a three year period.

In addition, in 2009 an additional discretionary award was made in April, May and September 2009. The performance conditions for those awards are as follows:

Synergy savings: The release of 50 per cent of the shares will be dependent on the achievement of target run-rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of at least £1.5 billion by the end of 2011. The award will be broken down into three equally weighted annual tranches. Performance will be assessed at the end of each year against annual performance targets based on a trajectory to meet the 2011 target. The extent to which targets have been achieved will determine the proportion of shares to be banked each year. No shares will be released subject to the remuneration committee judging the overall success of the delivery of the integration programme.

Integration balanced scorecard: The release of the remaining 50 per cent of the shares will be dependent on the outcome of a balanced scorecard of non-financial measures of the success of the integration in each of 2009, 2010 and 2011. The balanced scorecard element will be broken down into three equally weighted tranches. The tranches will be crystallised and banked for each year of the performance cycle subject to separate annual performance targets across the four measurement categories of Building the Business, Customer, Risk and People and Organisation Development.

	2009 Number of shares	2008 Number of shares
Outstanding at 1 January	**22,237,292**	13,209,081
Granted	**199,293,192**	10,519,609
Rebasement adjustment	**10,443,102**	–
Forfeited	**(8,740,524)**	(1,491,408)
Outstanding at 31 December	**223,233,052**	22,237,282

The fair value of the share awards granted in 2009 was £0.68 (2008: £2.28).

Conditional awards of shares made under this plan were adjusted on 2 July 2009 as a result of the Placing and Compensatory Open Offer. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising event.

Performance share plan

Under the performance share plan, introduced during 2005, participating executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 bonus. The maximum match will be two performance shares for each bonus share, awarded at the end of a three year period. The actual number of Lloyds Banking Group plc's shares awarded was dependent on Lloyds Banking Group's total shareholder return performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share was awarded only if Lloyds Banking Group plc's total shareholder return performance placed it first in the comparator group; one performance share for each bonus share was granted if Lloyds Banking Group is placed fifth; and one performance share for every two bonus shares if Lloyds Banking Group was placed eighth (median). Between first and fifth position and fifth and eighth position sliding scales will apply. If the total shareholder return performance was below median, no performance shares were awarded. There was no retest. Whilst income tax and national insurance was deducted from the bonus before deferral into the plan, where a match of performance shares was justified, these shares were awarded as if income tax and national insurance had not been deducted.

47 Share based payments (continued)

The performance condition attached to the March 2005 award was met, with Lloyds Banking Group ranked in fifth place. Bonus shares were released on 18 March 2008, with one performance share granted for each bonus share. Performance shares were released on 10 April 2008.

The performance condition attached to the March 2006 award was not met, with Lloyds Banking Group ranked in to ninth place. Bonus shares were released on 20 March 2009, at which time the performance shares lapsed.

	2009 Number of shares	2008 Number of shares
Outstanding at 1 January	**941,324**	1,767,594
Forfeited	**–**	(74,691)
Lapsed	**(941,324)**	(375,790)
Released	**–**	(375,789)
Outstanding at 31 December	**–**	941,324

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding for the option schemes were as follows:

	Executive schemes			**SAYE schemes**			**Other share option plans**		
	Weighted average exercise price (pence)	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**
31 December 2009									
Exercise price range									
£0 to £1	**–**	**–**	**–**	**–**	**–**	**–**	**Nil**	**3.1**	**26,099,185**
£1 to £2	**–**	**–**	**–**	**139.00**	**2.5**	**107,939,699**	**–**	**–**	**–**
£2 to £3	**–**	**–**	**–**	**284.00**	**–**	**165,847**	**–**	**–**	**–**
£3 to £4	**–**	**–**	**–**	**348.70**	**1.9**	**2,753,342**	**–**	**–**	**–**
£4 to £5	**464.19**	**4.9**	**7,526,441**	**427.04**	**1.8**	**1,296,884**	**–**	**–**	**–**
£5 to £6	**552.02**	**0.2**	**515,527**	**–**	**–**	**–**	**–**	**–**	**–**
£6 to £7	**653.55**	**1.2**	**743,010**	**–**	**–**	**–**	**–**	**–**	**–**
£7 to £8	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
£8 to £9	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2008									
Exercise price range									
£0 to £1	–	–	–	–	–	–	Nil	2.5	857,611
£1 to £2	–	–	–	139.00	3.5	178,932,603	–	–	–
£2 to £3	–	–	–	284.00	0.4	941,414	–	–	–
£3 to £4	–	–	–	344.75	1.9	7,366,320	–	–	–
£4 to £5	453.77	5.9	9,132,197	423.49	2.0	3,200,532	–	–	–
£5 to £6	551.25	1.2	741,905	588.50	0.3	37,580	–	–	–
£6 to £7	652.30	2.1	997,326	–	–	–	–	–	–
£7 to £8	–	–	–	–	–	–	–	–	–
£8 to £9	863.63	0.3	332,200	–	–	–	–	–	–

The fair value calculations at 31 December 2009 for grants made in the year are based on the following assumptions:

	SAYE	**Other option schemes**	**Other share plans**
Risk-free interest rate	**Nil**	**2.01%**	**2.23%**
Expected life	**Nil**	**2.6 years**	**3.0 years**
Expected volatility	**Nil**	**90%**	**84%**
Expected dividend yield	**Nil**	**1.7%**	**1.8%**
Weighted average share price	**Nil**	**£0.71**	**£0.71**
Weighted average exercise price	**Nil**	**Nil**	**Nil**
Expected forfeitures	**Nil**	**4%**	**4%**

Expected volatility is a measure of the amount by which Lloyds Banking Group plc's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in Lloyds Banking Group plc's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

47 Share based payments (continued)

Share incentive plan

Free shares

An award of Lloyds Banking Group plc shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000. The percentage is normally announced concurrently with Lloyds Banking Group's annual results and the price of the shares awarded is announced at the time of award. The shares awarded are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition: if an employee leaves Lloyds Banking Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited (for certain awards made up to April 2005, only a portion of the shares will be forfeited: 75 per cent within one year of the award, 50 per cent within two years and 25 per cent within three years).

No free shares were awarded in 2009 (2008: 8,862,823, with an average fair value of £4.38, based on the market price at the date of award).

Matching shares

Lloyds Banking Group undertakes to match shares purchased by employees up to the value of £30 per month, these shares are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited, similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

The number of shares awarded relating to matching shares in 2009 was 16,746,310 (2008: 4,475,264), with an average fair value of £0.69 (2008: £2.56), based on market prices at the date of award.

48 Related party transactions

Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the Group's key management personnel are the members of Lloyds Banking Group plc group executive committee together with its non-executive directors.

The table below details, on an aggregated basis, key management personnel compensation:

	2009 £m	2008 £m
Compensation		
Salaries and other short-term benefits	**8**	8
Post-employment benefits	**1**	1
Share based payments	**–**	4
Total	**9**	13

The aggregate of the emoluments of the directors was £4,950,000 (2008: £5,623,000).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were three and two respectively (2008: three and three). Aggregate company contributions in respect of directors to defined contribution pension schemes were £214,000 (2008: £205,000).

The total for the highest paid director (Mr Tate) was £903,000 (2008: (Mr Daniels) £1,151,000); this did not include any gain on exercise or Lloyds Banking Group plc shares in either year.

	2009 million	2008 million
Share options over Lloyds Banking Group plc shares		
At 1 January	**2**	7
Granted (including options of appointed directors)	**–**	–
Exercised/lapsed (including options of former directors)	**–**	(5)
At 31 December	**2**	2

	2009 million	2008 million
Share incentive plans over Lloyds Banking Group plc shares		
At 1 January	**7**	6
Granted (including entitlements of appointed directors)	**17**	3
Exercised/lapsed (including entitlements of former directors)	**(5)**	(2)
At 31 December	**19**	7

48 Related party transactions (continued)

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between the Group and its key management personnel:

	2009 £m	2008 £m
Loans		
At 1 January	**3**	2
Advanced (including loans of appointed directors)	**–**	2
Repayments (including loans of former directors)	**(1)**	(1)
At 31 December	**2**	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 1.28 per cent and 24.9 per cent in 2009 (2008: 2.14 per cent and 34.01 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2008: £nil).

	2009 £m	2008 £m
Deposits		
At 1 January	**6**	5
Placed (including deposits of appointed directors)	**12**	27
Withdrawn (including deposits of former directors)	**(14)**	(26)
At 31 December	**4**	6

Deposits placed by key management personnel attracted interest rates of up to 6.5 per cent (2008: 6.0 per cent).

At 31 December 2009, the Group did not provide any guarantees in respect of key management personnel (2008: £nil).

At 31 December 2009, transactions, arrangements and agreements entered into by the Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2 million with seven directors and four connected persons (2008: £3 million with eight directors and six connected persons).

Balances and transactions with fellow Lloyds Banking Group undertakings

Balances and transactions between members of the Lloyds TSB Bank group

In accordance with IAS 27, transactions and balances between the Bank and its subsidiary undertakings, and between those subsidiary undertakings, have all been eliminated on consolidation and thus are not reported as related party transactions of the Group.

The Bank, as a result of its position as parent of a banking group, has a large number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Bank as follows:

	2009 £m	2008 £m
Assets, included within:		
Derivative financial instruments	**301**	616
Loans and receivables		
Loans and advances to banks	**29,046**	11,322
Loans and advances to customers	**49,088**	50,785
Debt securities	**11,064**	–
Available-for-sale financial assets	**13,364**	18,575
Other assets	**–**	411
	102,863	81,709
Liabilities, included within:		
Deposits from banks	**21,369**	14,141
Customer deposits	**29,870**	31,500
Derivative financial instruments	**302**	1,834
Debt securities in issue	**27,837**	24,457
Other liabilities	**–**	571
Subordinated liabilities	**677**	707
	80,055	73,210

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2009 the Bank earned interest income on the above asset balances of £1,826 million (2008: £3,007 million) and incurred interest expense on the above liability balances of £1,364 million (2008: £2,989 million).

48 Related party transactions (continued)

In addition, the Bank raised recharges of £505 million (2008: £515 million) on its subsidiaries in respect of costs incurred and also received fees of £411 million (2008: £688 million), and paid fees of £322 million (2008: £365 million), for various services provided between the Bank and its subsidiaries.

Details of contingent liabilities and commitments entered into on behalf of fellow Lloyds Banking Group undertakings are given in note 49.

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

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Assets, included within:				
Derivative financial instruments	**923**	–	**923**	–
Loans and receivables				
Loans and advances to banks	**150,121**	–	**150,121**	–
Loans and advances to customers	**14,188**	–	**14,088**	–
Other	**909**	–	**435**	–
	166,141	–	**165,567**	–
Liabilities, included within:				
Deposits from banks	**86,512**	–	**86,512**	–
Customer deposits	**18,387**	1,426	**17,986**	1,394
Derivative financial instruments	**1,195**	1,297	**1,195**	1,297
Subordinated liabilities	**5,896**	2,956	**5,572**	2,956
Debt securities in issue	**671**	–	**391**	–
Other liabilities	**–**	15	**–**	15
	112,661	5,694	**111,656**	5,662

These balances include Lloyds Banking Group plc's banking arrangements and, due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2009 the Group earned £746 million and the Bank earned £724 million interest income on the above asset balances (2008: Group £nil; Bank £nil); the Group incurred £554 million and the Bank incurred £547 million interest expense on the above liability balances (2008: Group £176 million; Bank £176 million).

HM Treasury
On 13 January 2009, HM Treasury subscribed for approximately 2,597 million shares in Lloyds Banking Group plc, the Bank's parent company, which gave it a 30.2 per cent interest in the Lloyds Banking Group plc's ordinary share capital. Consequently, HM Treasury became a related party of the Bank from this date. The material transactions entered into with HM Treasury from 13 January 2009 are described below.

Credit Guarantee Scheme
HM Treasury launched the Credit Guarantee Scheme in October 2008 as part of a range of measures announced by the UK Government intended to ease the turbulence in the UK banking system. It charges a commercial fee for the guarantee of new short and medium-term debt issuance. The fee payable to HM Treasury on guaranteed issues is based on a per annum rate of 50 basis points plus the median five-year credit default swap spread. At 31 December 2009, the Group had £40,345 million of debt issued under the Credit Guarantee Scheme. During the period from 13 January 2009 to 31 December 2009, fees of £262 million payable to HM Treasury in respect of guaranteed funding were included in the Group's income statement.

Other than the Government Asset Protection Scheme fee of £2,500 million, there were no other material transactions between the Group and HM Treasury during the period between 13 January 2009 and 31 December 2009 that were not made in the ordinary course of business or that are unusual in their nature or conditions.

Other related party disclosures
At 31 December 2009, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £53 million (2008: £23 million).

The Group manages 109 (2008: 105) Open Ended Investment Companies (OEICs) and of these 47 (2008: 47) are consolidated. The Group invested £412 million (2008: £455 million) and redeemed £362 million (2008: £343 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £3,365 million (2008: £2,661 million) at 31 December. The Group earned fees of £188 million from the unconsolidated OEICs (2008: £206 million). The Bank held no investments in OEICs at any time during 2008 or 2009.

The Group has a number of associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2009, these companies had total assets of approximately £3,024 million (2008: £5,838 million), total liabilities of approximately £3,194 million (2008: £5,780 million) and for the year ended 31 December 2009 had turnover of approximately £1,804 million (2008: £2,088 million) and made a net loss of approximately £16 million (2008: net loss of £80 million). In addition, the Group has provided £868 million (2008: £825 million) of financing to these companies on which it received £51 million (2008: £46 million) of interest income in the year.

49 Contingent liabilities and commitments

Payment Protection Insurance

In January 2009, the UK Competition Commission (the 'Competition Commission') completed its formal investigation into the supply of Payment Protection Insurance (PPI) services (except store card PPI) to non-business customers in the UK and published its final report setting out its remedies. Prior to this the Group had made the commercial decision to sell only regular monthly premium PPI to its personal loan customers. The Competition Commission decided to adopt various remedies including a prohibition on the active sale of PPI by a distributor to a customer within 7 days of the distributor's sale of credit to that customer.

On 30 March 2009, Barclays Bank plc lodged an appeal in the UK Competition Appeal Tribunal (the 'Competition Appeal Tribunal') against the Competition Commission's findings. Lloyds Banking Group was granted permission by the Competition Appeal Tribunal to intervene in the appeal. The Competition Appeal Tribunal handed down its judgment on 16 October 2009 finding in favour of Barclays in respect of its challenge to the Competition Commission's prohibition of distributors selling PPI at the credit point of sale but it did not uphold Barclays' challenge to the Competition Commission's findings on market definition. The matter has now been referred back to the Competition Commission. This may or may not result in the Competition Commission ultimately reaching a different conclusion.

On 1 July 2008 the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The Group has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints. On 29 September 2009, the FSA issued a consultation paper on PPI complaints handling. The FSA has escalated its regulatory activity in relation to past PPI sales generally and has proposed new guidance on the fair assessment of a complaint and the calculation of redress and a new rule requiring firms to reassess historically rejected complaints.

The statement on 29 September 2009 also announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. The Group has subsequently agreed in principle that it will undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. The precise details of the review are still being discussed with the FSA. The ultimate impact on the Group of any review and/or reassessment can only be known at the conclusion of these discussions and on publication of the FSA's final rules.

US economic sanctions

Starting in 2007 Lloyds TSB Bank plc provided information in relation to its review of historic US Dollar payments involving countries, persons or entities subject to US economic sanctions administered by the Office of Foreign Assets Control ('OFAC') to a number of authorities reported to be conducting a review of sanctions compliance by non-US financial institutions. On 9 January 2009 the settlement reached by Lloyds TSB Bank plc with both the US Department of Justice and the New York County District Attorney's Office in relation to their investigations was announced. The settlement documentation contains details of the results of the investigations including the identification of certain activities relating to Iran, Sudan and Libya which Lloyds TSB Bank plc conducted during the relevant period. In 2008, Lloyds TSB Bank plc made a provision of £180 million which fully covered the settlement amount paid to the Department of Justice and the New York County District Attorney's Office. On 22 December 2009 OFAC announced the settlement it had reached with Lloyds TSB Bank plc in relation to its investigation and confirmed that the settlement sum due to OFAC had been fully satisfied by Lloyds TSB Bank plc's payment to the Department of Justice and the New York County District Attorney's Office. No further enforcement actions are expected in relation to the matters set out in the settlement agreements.

A purported shareholder filed a derivative civil action in the Supreme Court of New York, Nassau County on 26 February 2009 against certain current and former directors, and nominally against Lloyds TSB Bank plc and the Lloyds Banking Group, seeking various forms of relief following the settlement. The derivative action is at a very early stage but the ultimate outcome of the action is not expected to have a material impact on the Group.

Interchange fees

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the General Court of the European Union (the 'General Court'). Bank of Scotland plc and Lloyds TSB Bank plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with European Commission competition laws. Meanwhile, the European Commission and the UK's OFT are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions also infringe European Commission and/or UK competition laws. As part of this initiative the OFT will also intervene in the General Court appeal supporting the European Commission's position. The ultimate impact of the investigations on the Lloyds Banking Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

Unarranged overdraft charges

The Supreme Court published its judgment in respect of the fairness of unarranged overdraft charges on personal current accounts on 25 November 2009, finding in favour of the litigant banks. On 22 December 2009, the OFT announced that it will not continue its investigation into the fairness of these charges. The Group is working with the regulators to ensure that outstanding customer complaints are concluded as quickly as possible and anticipate that most cases in the county courts will be discontinued. The Group expects that some customers will argue that despite the test case ruling they are entitled to a refund of unarranged overdraft charges on the basis of other legal arguments or challenges. The Group would robustly defend any such complaints or claims and does not expect the outcome of any such complaints or claims to have a material adverse effect on its financial position.

Other legal proceedings

In addition, during the ordinary course of business the Lloyds Banking Group is subject to threatened or actual legal proceedings. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Lloyds Banking Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed to properly assess the merits of the case. No provisions are held against such cases, however the Lloyds Banking Group does not currently expect the final outcome of these cases to have a material adverse effect on its financial position.

49 Contingent liabilities and commitments (continued)

Contingent liabilities and commitments arising from the banking business

Acceptances and endorsements arise where the Group or the Bank agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, where the Group or the Bank has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction-related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

The Group's and the Bank's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Contingent liabilities				
Acceptances and endorsements	**53**	49	**54**	49
Other:				
Other items serving as direct credit substitutes	**1,395**	1,870	**1,276**	1,758
Performance bonds and other transaction-related contingencies	**3,292**	2,850	**2,772**	2,886
	4,687	4,720	**4,048**	4,644
	4,740	4,769	**4,102**	4,693

	The Bank	
	2009 £m	2008 £m
Incurred on behalf of fellow Lloyds Banking Group undertakings	**30**	39

The contingent liabilities of the Group and the Bank, as detailed above, arise in the normal course of banking business and it is not practicable to quantify their future financial effect.

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Commitments				
Documentary credits and other short-term trade-related transactions	**219**	319	**219**	323
Forward asset purchases and forward deposits placed	**758**	613	**3,373**	713
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year original maturity:				
Mortgage offers made	**1,302**	3,056	**1,135**	2,800
Other commitments	**36,206**	46,006	**33,681**	56,192
	37,508	49,062	**34,816**	58,992
1 year or over original maturity	**36,020**	31,761	**43,545**	30,710
	74,505	81,755	**81,953**	90,738

	The Bank	
	2009 £m	2008 £m
Incurred on behalf of fellow Lloyds Banking Group undertakings	**12,467**	13,424

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £44,327 million (2008: £46,890 million) for the Group and £39,469 million (2008: £42,588 million) for the Bank were irrevocable.

49 Contingent liabilities and commitments (continued)

Operating lease commitments
Where a Group company is the lessee, the future minimum lease payments under non-cancellable premises operating leases are as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2007 £m
Not later than 1 year	**204**	216	**188**	198
Later than 1 year and not later than 5 years	**554**	647	**506**	589
Later than 5 years	**622**	774	**552**	694
	1,380	1,637	**1,246**	1,481

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

Capital commitments
Excluding commitments of the Group in respect of investment property (note 22), capital expenditure contracted but not provided for at 31 December 2009 amounted to £96 million for the Group and £5 million for the Bank (2008: £92 million for the Group and £6 million for the Bank). Of this amount, £91 million (2008: £85 million) relates to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

50 Financial instruments

(1) Measurement basis of financial assets and liabilities
The accounting policies in accounting policy 2(e) describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

The Group		At fair value through profit or loss						
	Derivatives designated as hedging instruments £m	Held for trading £m	Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2009								
Financial assets								
Cash and balances at central banks	**–**	**–**	**–**	**–**	**–**	**36,089**	**–**	**36,089**
Items in the course of collection from banks	**–**	**–**	**–**	**–**	**–**	**1,045**	**–**	**1,045**
Trading and other financial assets at fair value through profit or loss	**–**	**542**	**48,352**	**–**	**–**	**–**	**–**	**48,894**
Derivative financial instruments	**995**	**17,802**	**–**	**–**	**–**	**–**	**–**	**18,797**
Loans and receivables:								
Loans and advances to banks	**–**	**–**	**–**	**–**	**175,554**	**–**	**–**	**175,554**
Loans and advances to customers	**–**	**–**	**–**	**–**	**245,226**	**–**	**–**	**245,226**
Debt securities	**–**	**–**	**–**	**–**	**2,636**	**–**	**–**	**2,636**
	–	**–**	**–**	**–**	**423,416**			**423,416**
Available-for-sale financial assets	**–**	**–**	**–**	**26,089**	**–**	**–**	**–**	**26,089**
Total financial assets	**995**	**18,344**	**48,352**	**26,089**	**423,416**	**37,134**	**–**	**554,330**
Financial liabilities								
Deposits from banks	**–**	**–**	**–**	**–**	**–**	**139,557**	**–**	**139,557**
Customer deposits	**–**	**–**	**–**	**–**	**–**	**193,045**	**–**	**193,045**
Items in course of transmission to banks	**–**	**–**	**–**	**–**	**–**	**542**	**–**	**542**
Trading and other financial liabilities at fair value through profit or loss	**–**	**202**	**6,160**	**–**	**–**	**–**	**–**	**6,362**
Derivative financial instruments	**702**	**16,031**	**–**	**–**	**–**	**–**	**–**	**16,733**
Debt securities in issue	**–**	**–**	**–**	**–**	**–**	**120,719**	**–**	**120,719**
Liabilities arising from insurance contracts and participating investment contracts	**–**	**–**	**–**	**–**	**–**	**–**	**36,960**	**36,960**
Liabilities arising from non-participating investment contracts	**–**	**–**	**–**	**–**	**–**	**–**	**15,734**	**15,734**
Unallocated surplus within insurance businesses	**–**	**–**	**–**	**–**	**–**	**–**	**310**	**310**
Subordinated liabilities	**–**	**–**	**–**	**–**	**–**	**15,999**	**–**	**15,999**
Total financial liabilities	**702**	**16,233**	**6,160**	**–**	**–**	**469,862**	**53,004**	**545,961**

50 Financial instruments (continued)

The Group

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2008								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	5,008	–	5,008
Items in the course of collection from banks	–	–	–	–	–	946	–	946
Trading and other financial assets at fair value through profit or loss	–	857	44,258	–	–	–	–	45,115
Derivative financial instruments	435	28,449	–	–	–	–	–	28,884
Loans and receivables:								
Loans and advances to banks	–	–	–	–	38,733	–	–	38,733
Loans and advances to customers	–	–	–	–	240,344	–	–	240,344
Debt securities	–	–	–	–	4,416	–	–	4,416
	–	–	–	–	283,493	–	–	283,493
Available-for-sale financial assets	–	–	–	55,707	–	–	–	55,707
Total financial assets	435	29,306	44,258	55,707	283,493	5,954	–	419,153
Financial liabilities								
Deposits from banks	–	–	–	–	–	66,514	–	66,514
Customer deposits	–	–	–	–	–	172,364	–	172,364
Items in course of transmission to banks	–	–	–	–	–	508	–	508
Trading and other financial liabilities at fair value through profit or loss	–	6	6,748	–	–	–	–	6,754
Derivative financial instruments	4,169	24,020	–	–	–	–	–	28,189
Debt securities in issue	–	–	–	–	–	73,066	–	73,066
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	33,827	33,827
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	14,243	14,243
Unallocated surplus within insurance businesses	–	–	–	–	–	–	270	270
Subordinated liabilities	–	–	–	–	–	17,389	–	17,389
Total financial liabilities	4,169	24,026	6,748	–	–	329,841	48,340	413,124

50 Financial instruments (continued)

The Bank

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2009							
Financial assets							
Cash and balances at central banks	**–**	**–**	**–**	**–**	**–**	**35,964**	**35,964**
Items in the course of collection from banks	**–**	**–**	**–**	**–**	**–**	**1,004**	**1,004**
Trading and other financial assets at fair value through profit or loss	**–**	**510**	**2,123**	**–**	**–**	**–**	**2,633**
Derivative financial instruments	**952**	**16,985**	**–**	**–**	**–**	**–**	**17,937**
Loans and receivables:							
Loans and advances to banks	**–**	**–**	**–**	**–**	**176,556**	**–**	**176,556**
Loans and advances to customers	**–**	**–**	**–**	**–**	**253,111**	**–**	**253,111**
Debt securities	**–**	**–**	**–**	**–**	**2,830**	**–**	**2,830**
	–	**–**	**–**	**–**	**432,497**	**–**	**432,497**
Available-for-sale financial assets	**–**	**–**	**–**	**13,514**	**–**	**–**	**13,514**
Total financial assets	**952**	**17,495**	**2,123**	**13,514**	**432,497**	**36,968**	**503,549**
Financial liabilities							
Deposits from banks	**–**	**–**	**–**	**–**	**–**	**160,428**	**160,428**
Customer deposits	**–**	**–**	**–**	**–**	**–**	**201,053**	**201,053**
Items in course of transmission to banks	**–**	**–**	**–**	**–**	**–**	**492**	**492**
Trading and other financial liabilities at fair value through profit or loss	**–**	**202**	**6,160**	**–**	**–**	**–**	**6,362**
Derivative financial instruments	**772**	**16,057**	**–**	**–**	**–**	**–**	**16,829**
Debt securities in issue	**–**	**–**	**–**	**–**	**–**	**109,870**	**109,870**
Subordinated liabilities	**–**	**–**	**–**	**–**	**–**	**15,456**	**15,456**
Total financial liabilities	**772**	**16,259**	**6,160**	**–**	**–**	**487,299**	**510,490**

The Bank

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2008							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	4,890	4,890
Items in the course of collection from banks	–	–	–	–	–	909	909
Trading and other financial assets at fair value through profit or loss	–	857	2,822	–	–	–	3,679
Derivative financial instruments	435	26,269	–	–	–	–	26,704
Loans and receivables:							
Loans and advances to banks	–	–	–	–	36,968	–	36,968
Loans and advances to customers	–	–	–	–	249,363	–	249,363
Debt securities	–	–	–	–	3,863	–	3,863
	–	–	–	–	290,194	–	290,194
Available-for-sale financial assets	–	–	–	58,444	–	–	58,444
Total financial assets	435	27,126	2,822	58,444	290,194	5,799	384,820
Financial liabilities							
Deposits from banks	–	–	–	–	–	80,529	80,529
Customer deposits	–	–	–	–	–	184,041	184,041
Items in course of transmission to banks	–	–	–	–	–	467	467
Trading and other financial liabilities at fair value through profit or loss	–	6	6,748	–	–	–	6,754
Derivative financial instruments	1,963	27,767	–	–	–	–	29,730
Debt securities in issue	–	–	–	–	–	74,559	74,559
Subordinated liabilities	–	–	–	–	–	16,853	16,853
Total financial liabilities	1,963	27,773	6,748	–	–	356,449	392,933

50 Financial instruments (continued)

(2) Reclassification of financial assets
In accordance with the amendment to IAS39 that became applicable during 2008, the Group reviewed the categorisation of its financial assets classified as held for trading and available-for-sale.

On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, with effect from 1 July 2008, the Group transferred £2,993 million of assets previously classified as held for trading into loans and receivables. With effect from 1 November 2008, the Group transferred £437 million of assets previously classified as available-for-sale into loans and receivables. At the time of these transfers, the Group had the intention and ability to hold them for the foreseeable future or until maturity. As at the date of reclassification, the weighted average effective interest rate of the assets transferred was 6.3 per cent with the estimated recoverable cash flows of £3,524 million.

Carrying amount and fair values of reclassified assets
The table below sets out the carrying value and fair value of reclassified financial assets.

	31 December 2009		31 December 2008	
	Carrying value	**Fair value**	Carrying value	Fair value
	£m	**£m**	£m	£m
From held for trading to loans and receivables	**1,833**	**1,822**	2,883	2,926
From available-for-sale to loans and receivables	**394**	**422**	454	402
	2,227	**2,244**	3,337	3,328

During the year ended 31 December 2009, the carrying value of reclassified assets decreased by £1,110 million due to sales and maturities of £990 million, accretion of discount of £61 million and foreign exchange and other movements of £181 million.

Additional fair value gains (losses) that would have been recognised had the reclassifications not occurred
The table below shows the additional gains (losses) that would have been recognised in the Group's income statement if the reclassifications had not occurred.

	2009			2008	
	Reclassified in 2009 £m	**Reclassified in 2008 £m**	**Total £m**	Reclassified in 2008 £m	Total £m
From held for trading to loans and receivables	**–**	**208**	**208**	(347)	(347)

The table below shows the additional gains (losses) that would have been recognised in other comprehensive income if the reclassifications had not occurred.

	2009			2008	
	Reclassified in 2009 £m	**Reclassified in 2008 £m**	**Total £m**	Reclassified in 2008 £m	Total £m
From available-for-sale to loans and receivables	**–**	**161**	**161**	(108)	(108)

Actual amounts recognised in respect of reclassified assets
After reclassification the reclassified financial assets contributed the following amounts to the Group income statement

	2009			2008	
	Reclassified in 2009 £m	**Reclassified in 2008 £m**	**Total £m**	Reclassified in 2008 £m	Total £m
From held for trading to loans and receivables:					
Net interest income	**–**	**55**	**55**	31	31
Impairment losses	**–**	**(49)**	**(49)**	(158)	(158)
Total	**–**	**6**	**6**	(127)	(127)

	2009			2008	
	Reclassified in 2009 £m	**Reclassified in 2008 £m**	**Total £m**	Reclassified in 2008 £m	Total £m
From available-for-sale to loans and receivables:					
Net interest income	**–**	**34**	**34**	3	3
Impairment losses	**–**	**(56)**	**(56)**	(23)	(23)
Total	**–**	**(22)**	**(22)**	(20)	(20)

50 Financial instruments (continued)

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

	The Group				The Bank			
	Carrying value		Fair value		Carrying value		Fair value	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Financial assets								
Trading and other financial assets at fair value through profit or loss	**48,894**	45,115	**48,894**	45,115	**2,633**	3,679	**2,633**	3,679
Derivative financial instruments	**18,797**	28,884	**18,797**	28,884	**17,937**	26,704	**17,937**	26,704
Loans and receivables:								
Loans and advances to banks	**175,554**	38,733	**175,535**	37,954	**176,556**	36,968	**176,537**	36,188
Loans and advances to customers	**245,226**	240,344	**241,553**	235,569	**253,111**	249,363	**239,096**	244,353
Debt securities	**2,636**	4,416	**2,699**	3,981	**2,830**	3,863	**2,894**	3,504
	423,416	283,493	**419,787**	277,504	**432,497**	290,194	**418,527**	284,045
Available-for-sale financial assets	**26,089**	55,707	**26,089**	55,707	**13,514**	58,444	**13,514**	58,444
Financial liabilities								
Deposits from banks	**139,557**	66,514	**139,478**	66,504	**160,428**	80,529	**160,349**	80,520
Customer deposits	**193,045**	172,364	**192,892**	172,545	**201,053**	184,041	**200,887**	184,236
Trading and other financial liabilities at fair value through profit or loss	**6,362**	6,754	**6,362**	6,754	**6,362**	6,754	**6,362**	6,754
Derivative financial instruments	**16,733**	28,189	**16,733**	28,189	**16,829**	29,730	**16,829**	29,730
Debt securities in issue	**120,719**	73,066	**120,458**	73,646	**109,870**	74,559	**109,790**	74,254
Liabilities arising from non-participating investment contracts	**15,734**	14,243	**15,734**	14,243	**–**	–	**–**	–
Financial guarantees	**38**	35	**38**	35	**38**	35	**38**	35
Subordinated liabilities	**15,999**	17,389	**14,963**	11,788	**15,455**	16,853	**14,419**	11,649

Valuation methodology
Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market 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.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that do not meet the definition of a financial instrument. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships; premises and equipment; and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

Valuation of financial instruments carried at fair value
The table below provides an analysis of the financial assets and liabilities of the Group that are carried at fair value in the Group's consolidated balance sheet, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

Valuation Hierarchy

At 31 December 2009	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Trading and other financial assets at fair value through profit or loss	**34,956**	**12,347**	**1,591**	**48,894**
Available-for-sale financial assets	**11,984**	**13,361**	**744**	**26,089**
Derivative financial instruments	**1,858**	**16,873**	**66**	**18,797**
Financial assets	**48,798**	**42,581**	**2,401**	**93,780**
Trading and other financial liabilities at fair value through profit or loss	**–**	**6,364**	**–**	**6,364**
Derivative financial instruments	**10**	**16,723**	**–**	**16,733**
Financial guarantees	**–**	**–**	**38**	**38**
Financial liabilities	**10**	**23,087**	**38**	**23,135**

There were no significant transfers between level 2 and level 3 during the year.

50 Financial instruments (continued)

At 31 December 2008	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Trading and other financial assets at fair value through profit or loss	38,069	5,374	1,672	45,115
Available-for-sale financial assets	30,185	22,361	3,161	55,707
Derivative financial instruments	2,147	26,601	136	28,884
Financial assets	70,401	54,336	4,969	129,706
Trading and other financial liabilities at fair value through profit or loss	6	6,748	–	6,754
Derivative financial instruments	153	27,458	578	28,189
Financial guarantees	–	–	35	35
Financial liabilities	159	34,206	613	34,978

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine the fair values.

Level 1 portfolios
Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise treasury bills and other government securities.

Level 2 portfolios
Where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data, the instrument is considered to be level 2. Examples of such financial instruments include most over-the-counter derivatives, financial institution issued securities, certificates of deposit and certain asset-backed securities.

Level 3 portfolios
Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include the Group's venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. Certain of the Group's asset-backed securities, principally where there is no trading activity in such securities, are also classified as level 3.

	At 31 December 2009			
	Valuation basis/technique	**Main assumptions**	**Carrying Value**	**Effect of reasonably possible alternative assumptions**
			£m	**£m**
Trading and other financial assets at fair value through profit or loss:				
Asset-backed securities	Lead manager or broker quote /consensus pricing from market data provider.	Use of single pricing source	**79**	**–**
Venture capital investments	Various valuation techniques using IPEV Guidelines	Earnings multiples	**1,162**	**–**
Unlisted equities and property partnerships in the life funds	Third party valuations	n/a	**350**	**–**
			1,591	
Available-for-sale financial assets:				
Asset-backed securities	Lead manager or broker quote /consensus pricing from market data provider	Use or single pricing source	**744**	**10**
Derivative financial instruments:				
	Industry standard model / consensus pricing from market data provider.	Prepayment rates, probability of default, loss given default and yield curves	**66**	**–**
Financial assets			**2,401**	
Financial guarantees			**38**	**–**
Financial liabilities			**38**	

50 Financial instruments (continued)

Reasonably possible alternative valuations have been calculated for asset-backed securities by using alternative pricing sources and calculating an absolute difference. In respect of derivative financial instruments, reasonably possible alternative valuations have been calculated by flexing the spread between the underlying asset and the credit derivative, or adjusting market yields, by a reasonable amount.

The valuation techniques used for unlisted equities and venture capital investments vary depending on the nature of the investment. Further details of these are given below. As these factors differ for each investment depending on the nature of the valuation technique used and the inputs, there is no single common factor that could be adjusted to provide a reasonable alternative valuation for these investment portfolios. Third party valuers have been used to determine the value of unlisted equities and property partnerships included in the Group's life insurance funds. There is no single common factor that could be adjusted to provide a reasonable alternative valuation for all of these investments.

The main products where level 3 valuations have been used are described below:

Asset-backed securities
Where there is no trading activity in asset backed securities, valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes are used to determine an appropriate valuation. Asset-backed securities are then classified as either level 2 or level 3 depending on whether there is more than one consistent independent source of data. If there is a single, uncorroborated market source for a significant valuation input or where there are materially inconsistent levels then the valuation is reported as level 3. Asset classes classified as level 3 mainly comprise certain Residential Mortgage Backed Securities, Collateralised Loan Obligations and Collateralised Debt Obligations.

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

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

Unquoted equities and property partnerships in the life funds
Third party valuations are used to obtain the fair value of unquoted investments. Management take account of any pertinent information, such as recent transactions and information received on particular investments, to adjust the third party valuations where necessary.

Derivatives
Where the Group's derivative assets and liabilities are not traded on an exchange, they are valued using valuation techniques, including discounted cash flow and options pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

- Interest rate swaps are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from publicly quoted rates.
- Foreign exchange derivatives that do not contain options are priced using rates available from publicly quoted sources.
- Credit derivatives, except for the items classified as level 3, are valued using publicly available yield and credit default swap curves; the Group uses standard models with observable inputs.
- Less complex interest rate and foreign exchange option products are valued using volatility surfaces developed from publicly available interest rate cap, interest rate swaption and other option volatilities; option volatility skew information is derived from a market standard consensus pricing service. For more complex option products, the Group calibrates its models using observable at-the-money data; where necessary, the Group adjusts for out-of-the-money positions using a market standard consensus pricing service.

Credit valuation adjustment
A credit valuation adjustment (CVA) is applied to the Group's over-the-counter derivative instruments to adjust the counterparty credit risk free derivative valuations provided by standard interbank lending interest rate curves. The Group uses a simulation model to develop expected future exposures and calculate a bi-lateral CVA. Credit and debit valuation adjustments are calculated by counterparty and the net adjustment booked. At 31 December 2009 the total reserve booked was £78 million (31 December 2008 £196 million). This adjustment has been made to the valuation of over-the-counter derivative instruments classified as level 2.

50 Financial instruments (continued)

Movements in Level 3 Portfolio

The table below analyses movements in the Level 3 financial assets portfolio.

	Trading and other financial assets at fair value through profit or loss £m	Available for sale £m	Derivative assets £m	Total financial assets £m
At 31 December 2008	**1,672**	**3,161**	**136**	**4,969**
Exchange and other adjustments	**(4)**	**(63)**	**–**	**(67)**
Gains (losses) recognised in the income statement	**(50)**	**6**	**(69)**	**(113)**
Gains (losses) recognised in other comprehensive income	**–**	**50**	**–**	**50**
Purchases	**340**	**19**	**–**	**359**
Sales	**(400)**	**(412)**	**(1)**	**(813)**
Transfers into the Level 3 portfolio	**33**	**36**	**–**	**69**
Transfers out of the Level 3 portfolio	**–**	**(2,053)**	**–**	**(2,053)**
At 31 December 2009	**1,591**	**744**	**66**	**2,401**

The table below analyses movements in the Level 3 financial liabilities portfolio.

	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities £m
At 31 December 2008	**578**	**35**	**613**
Gains recognised in the income statement	**(104)**	**–**	**(104)**
Additions	**–**	**3**	**3**
Redemptions	**(474)**	**–**	**(474)**
At 31 December 2009	**–**	**38**	**38**

Transfers out of the Level 3 portfolio arise when inputs that could have a significant impact on the instrument's valuation become market observable after previously having been non-market observable. In the case of asset-backed securities this can arise if more than one consistent independent source of data becomes available. Conversely transfers into the portfolio arise when consistent sources of data cease to be available.

Included with the gains (losses) recognised in the income statement are losses of £106 million related to financial instruments that are held at 31 December 2009. These amounts are included in other operating income.

Fair value of financial instruments carried at amortised cost

Loans and receivables

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair values of asset-backed securities and secondary loans, which were previously within assets held for trading and were reclassified to loans and receivables (see page 76), are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

Deposits from banks and customer deposits

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue and subordinated liabilities

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

51 Financial risk management

Financial instruments are fundamental to the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and currency risk; liquidity risk and insurance risk. Qualitative and quantitative information about the Group's management of these risks is given below.

QUALITATIVE INFORMATION

(1) Credit risk

Definition

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

Risk appetite

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

Exposures

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out within this note below.

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

Credit risk can also arise from debt securities, private equity investments, derivatives and foreign exchange activities. Note 14 to the financial statements shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2009. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. Such amounts are reflected in the credit risk table on page 87.

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

Measurement

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

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

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

The rating systems described above assess probability of default, exposure at default and loss given default, in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment (see note 20). Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss models that are used for internal operational management and banking regulation purposes.

Mitigation

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

Internal control

- Credit principles and policy: Lloyds Banking Group Risk sets out the Group's credit principles and policy according to which credit risk is managed, which in turn is the basis for business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Business unit policy includes lending guidelines, which define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions.
- Counterparty limits: Limits are set against all types of exposure in a counterparty name, in accordance with an agreed methodology for each exposure type. This includes credit risk exposure on individual derivative transactions, which incorporates potential future exposures from market movements. Aggregate facility levels by counterparty are set and limit breaches are subject to escalation procedures.

51 Financial risk management (continued)

- Individual credit assessment and sanction: Credit risk in wholesale portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. The Group's credit risk appetite criteria for counterparty underwriting are the same as that for assets intended to be held over the period to maturity.
- Credit scoring: In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring). Business unit risk departments review scorecard effectiveness and approve changes, with material changes being subject to Lloyds Banking Group Risk approval.
- Controls over rating systems: The Group has established an independent process built on a set of common minimum standards designed to challenge the discriminatory power of the systems, accuracy of calibration and ability to rate consistently over time and across obligors. The internal rating systems are developed and implemented by independent risk functions in the business units with the business unit managing directors having ownership of the systems. They also take responsibility for ensuring the validation of the respective internal rating systems, supported and challenged by specialist functions in their respective business unit.
- Cross-border and cross-currency exposures: Country limits are authorised by the Lloyds Banking Group Country Limits Panel taking into account economic and political factors.
- Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite. Credit policy is aligned to the Group's risk appetite and restricts exposure to certain high risk and more vulnerable sectors and segments. Note 16 provides an analysis of loans and advances to customers by industry (for wholesale customers) and product (for retail customers). Exposures are monitored to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.
- Stress testing and scenario analysis: The credit portfolio is also subjected to stress-testing and scenario analysis, to simulate outcomes and calculate their associated impact. Events are modelled at a Group-wide level, at business unit level and by rating model and portfolio, for example, for a specific industry sector.
- Specialist expertise: Credit quality is maintained by specialist units providing, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.
- Daily settlement limits: Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the Group's market transactions on any single day.
- Risk assurance and oversight: Oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

Collateral
The principal collateral types for loans and advances are:

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

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

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

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

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

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

51 Financial risk management (continued)

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

Monitoring

- Portfolio monitoring and reporting: In conjunction with Lloyds Banking Group Risk, business units identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. Lloyds Banking Group Risk in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Lloyds Banking Group Business Risk Committee.
- The performance of all rating models is comprehensively monitored on a regular basis, to seek to ensure that models continue to provide optimum risk differentiation capability, the generated ratings remain as accurate and robust as possible and the models assign appropriate risk estimates to grades/pools. All models are monitored against a series of agreed key performance indicators. In the event that monthly monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated.

(2) Market risk

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

Risk appetite
Market risk appetite is defined with regard to the quantum and composition of market risk that exists currently in the Group and the direction in which the Lloyds Banking Group wishes to manage this. This statement of the Lloyds Banking Group's overall appetite for market risk is reviewed and approved annually by the Lloyds Banking Group board.

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

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

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

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

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

- The management of the With Profit Funds within the Group's insurance companies involves mismatching of assets and liabilities with the aim of generating a higher rate of return on assets to meet policyholders' expectations.
- Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets. (This forms part of the value-of-in-force (VIF) see note 24).
- For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch.
- Surplus assets are held primarily in three portfolios: (a) surpluses in the long-term funds of Scottish Widows plc and its subsidiaries; (b) assets in shareholder funds of life assurance companies and (c) an investment portfolio within the general insurance business.

The Group's defined benefit staff pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily equity and real interest rate risk. For further information on pension scheme assets and liabilities please refer to note 38.

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

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

Banking – trading assets and other treasury portfolios
With the acquisition of HBOS plc, it has been the policy of Lloyds Banking Group to monitor and report its trading and other treasury positions on a consolidated basis to facilitate management and control and capture diversification benefits. It is therefore not appropriate to report this data separately for the Group.

51 Financial risk management (continued)

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

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

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

The estimated impact of an immediate 25 basis point increase in interest rates on economic value for the year ended 31 December 2009 was £44 million (2008: decrease of £23 million). Economic value is defined as the present value of the non-trading portfolios concerned. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. No currency breakdown has been provided as most of the exposure is in pounds sterling. These calculations are made monthly using assumptions regarding the maturity of interest rate insensitive assets and liabilities. The portfolio is updated monthly to reflect any changes in the relationship between customer behaviour and the level of interest rates. This is a risk-based disclosure and the amounts below would be amortised in the income statement over the duration of the portfolio.

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

Insurance portfolios

The Group's market risk exposure in respect of insurance activities described above is measured using European Embedded Value (EEV) as a proxy for economic value. The pre-tax sensitivity of EEV to standardised stresses is shown below for the years ended 31 December 2009 and 2008. During 2009, the credit spread sensitivity was changed from a 25 basis point increase to a 30 per cent widening of the spread between corporate bonds and the swap curve including an allowance for the assumed change in the illiquidity premium. Foreign exchange risk arises predominantly from overseas equity holdings. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. Opening and closing numbers only have been provided as this data is not volatile and consequently is not tracked on a daily basis.

	31 December 2009 £m	31 December 2008 £m
Equity risk (impact of 10% fall pre-tax)	**(196)**	(236)
Interest rate risk (impact of 25bp reduction pre-tax)	**65**	59
Credit spread risk (impact of 30% increase pre-tax)	**(142)**	n/a

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

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

The Group incurs foreign exchange risk in the course of providing services to its customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

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

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

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

51 Financial risk management (continued)

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

Insurance activities

Market risk exposures from the insurance businesses are controlled via approved investment policies and triggers set with reference to the Group's overall risk appetite and regularly reviewed by the Lloyds Banking Group Asset and Liability Committee:

- The With Profit Funds are managed in accordance with the relevant fund's principles and practices of financial management and legal requirements.
- The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match the cash flows.
- Investment strategy for surplus assets held in excess of liabilities takes account of the legal, regulatory and internal business requirements for capital to be held to support the business now and in the future.

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

(3) Liquidity risk

Definition

Liquidity risk is defined as the risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost.

Consistent with regulatory requirements, the banking and insurance parts of the Group manage their liquidity independently on a stand-alone basis. Liquidity for all banking business is managed centrally. Liquidity risk taken in insurance business is managed at business unit level and is not considered further in this section.

Risk appetite

Liquidity risk appetite for the banking businesses is set by the Lloyds Banking Group board and reviewed on an annual basis. It is reported through various metrics that enable the Lloyds Banking Group to manage liquidity and funding constraints. Executive management, assisted by the Lloyds Banking Group Asset and Liability Committee, regularly reviews performance against risk appetite.

Exposure

Liquidity exposure represents the amount of potential outflows in any future period less committed inflows. Liquidity is considered from both an internal and regulatory perspective.

Measurement

A series of measures are used across the Group to monitor both short and long-term liquidity including: ratios, cash outflow triggers, liquidity gaps, early warning indicators and stress test survival period triggers. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

Mitigation

The Group mitigates the risk of a liquidity mismatch in excess of its risk appetite by managing the liquidity profile of the balance sheet through both short-term liquidity management and long-term funding strategy. Short-term liquidity management is considered from two perspectives; business as usual and liquidity under stressed conditions, both of which relate to funding in the less than one year time horizon. Longer-term funding is used to manage the Group's strategic liquidity profile which is determined by the Group's balance sheet structure. Longer-term is defined as having an original maturity of more than one year.

The Group's funding and liquidity position is underpinned by its significant retail deposit base, accompanied by appropriate funding from the wholesale markets. A substantial proportion of the retail deposit base is made up of customers' current and savings accounts which, although repayable on demand, have traditionally in aggregate provided a stable source of funding. Additionally, the Group accesses the short-term wholesale markets to raise inter-bank deposits and to issue certificates of deposit and commercial paper to meet short-term obligations. The Group's short-term money market funding is based on a qualitative analysis of the market's capacity for the Group's credit. The Group has developed strong relationships with certain wholesale market segments, and also has access to central banks and corporate customers, to supplement its retail deposit base.

Monitoring

Liquidity is actively monitored at business unit and Group level at an appropriate frequency. Routine reporting is in place to executive management and through the Lloyds Banking Group's committee structure, in particular the Lloyds Banking Group Asset and Liability Committee which meets monthly. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event. Liquidity policies and procedures are subject to independent oversight.

Daily monitoring and control processes are in place to address both statutory and prudential liquidity requirements. In addition, the framework has two other important components:

- Firstly, Lloyds Banking Group stress tests its potential cash flow mismatch position under various scenarios on an ongoing basis. The cash flow mismatch position considers on-balance sheet cash flows, commitments received and granted, and material derivative cash flows. Specifically, commitments granted include the pipeline of new business awaiting completion as well as other standby or revolving credit facilities. Behavioural adjustments are developed, evaluating how the cash flow position might change under each stress scenario to derive a stressed cash flow position. Scenarios cover both Lloyds Banking Group name specific and systemic difficulties. The scenarios and the assumptions are reviewed at least annually to gain assurance they continue to be relevant to the nature of the business.
- Secondly, the Group has a contingency funding plan embedded within the Lloyds Banking Group Liquidity Policy which has been designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing.

51 Financial risk management (continued)

(4) Insurance risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

Risk appetite

Insurance risk appetite is defined with regard to the quantum and composition of insurance risk that exists currently in the Group and the direction in which the Lloyds Banking Group wishes to manage this. It takes account of the need for each entity in the Lloyds Banking Group to maintain solvency in excess of the minimum level required by the entity's jurisdictional legal or regulatory requirements.

The Group's overall appetite for insurance risk is reviewed and approved annually by the Lloyds Banking Group board.

Exposure

The major sources of insurance risk within the Group are the insurance businesses and the Group's defined benefit staff pension schemes. The nature of insurance business involves the accepting of insurance risks which relate primarily to mortality, longevity, morbidity, persistency, expenses, property damage and unemployment. The prime insurance risk carried by the Group's staff pension schemes is related to longevity.

Measurement

Insurance risks are measured using a variety of techniques including stress and scenario testing; and, where appropriate, stochastic modelling.

Current and potential future insurance risk exposures are assessed and aggregated using risk measures based on 1-in-20 year stresses and other supporting measures where appropriate.

Mitigation

A key element of the control framework is the consideration of insurance risk by a suitable combination of high level committees/boards. For the life assurance businesses the key control body is the board of Scottish Widows Group Limited with the more significant risks also being subject to approval by the Lloyds Banking Group Executive Committee and/or Lloyds Banking Group board. For the general insurance businesses the key control body is the board of Lloyds TSB General Insurance Limited with the more significant risks again being subject to Lloyds Banking Group Executive Committee and/or Lloyds Banking Group board approval. All Group staff pension scheme issues are covered by the Lloyds Banking Group Asset and Liability and Business Risk Committees.

The overall insurance risk is mitigated through pooling and through diversification across large numbers of uncorrelated individuals, geographical areas, and different types of risk exposure. Insurance risk is primarily controlled via the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed)
- Pricing-to-risk (new insurance proposals are priced to cover the underlying risks inherent within the products)
- Claims management
- Product design
- Policy wording
- Product management
- The use of reinsurance or other risk mitigation techniques.

In addition, limits are used as a control mechanism for insurance risk at policy level.

At all times, close attention is paid to the adequacy of reserves, solvency management and regulatory requirements.

General insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Detailed modelling, including that of the potential losses under various catastrophe scenarios, supports the choice of reinsurance arrangements. Appropriate reinsurance arrangements also apply within the life and pensions businesses with significant mortality risk and morbidity risk being transferred to our chosen reinsurers.

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present.

In respect of insurance risks in the staff pension schemes, the Group ensures that effective communication mechanisms are in place for consultation with the trustees to assist with the management of risk in line with the Group's risk appetite.

Monitoring

Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations (for example claims experience, option take-up rates, persistency experience, expenses, non-disclosure at the point of sale), as well as evaluating the effectiveness of controls put in place to manage insurance risk. Reasons for any significant divergence from experience are investigated and remedial action is taken.

Insurance risk exposures are reported and monitored regularly by the Lloyds Banking Group Executive Committee.

51 Financial risk management (continued)

QUANTITATIVE INFORMATION

(1) Credit risk

The Group's credit risk exposure arises predominantly in the United Kingdom and the European Union.

The maximum credit risk exposure of the Group and the Bank in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Loans and receivables:				
Loans and advances to banks	**175,704**	38,868	**176,705**	37,103
Loans and advances to customers	**250,039**	243,803	**256,706**	252,063
Debt securities	**2,881**	4,549	**3,075**	3,996
Deposit amounts available for offset[1]	**(4,116)**	(4,837)	**(4,112)**	(4,827)
Impairment allowances	**(5,207)**	(3,727)	**(3,989)**	(2,968)
	419,301	278,656	**428,385**	285,367
Available-for-sale financial assets (excluding equity shares)	**26,008**	55,666	**13,438**	58,408
Trading and other financial assets at fair value through profit or loss (excluding equity shares)	**21,037**	21,790	**2,629**	3,674
Derivative assets, before netting	**18,797**	28,884	**17,937**	26,704
Amounts available for offset under master netting arrangements[1]	**(1,755)**	(10,598)	**(1,755)**	(10,598)
	17,042	18,286	**16,182**	16,106
Assets arising from reinsurance contracts held	**419**	385	**–**	–
Financial guarantees	**9,996**	10,382	**9,869**	10,382
Irrevocable loan commitments and other credit-related contingencies[2]	**48,541**	51,659	**43,564**	47,281
Maximum credit risk exposure	**542,344**	436,824	**514,067**	421,218
Maximum credit risk exposure before offset items	**548,215**	452,259	**519,934**	436,643

[1] Deposit amounts available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[2] See note 49 – Contingent liabilities and commitments for further information.

A general description of collateral held in respect of financial instruments is disclosed on page 82.

Loans and advances to banks – the Group may require collateral before entering into a credit commitment with another bank, depending on the type of the financial product and the counterparty involved, and netting agreements are obtained whenever possible and to the extent that such agreements are legally enforceable.

Available-for-sale debt securities, treasury and other bills, and trading and other financial assets at fair value through profit or loss – the credit quality of the Group's available-for-sale debt securities, treasury and other bills, and the majority of the Group's trading and other financial assets at fair value through profit or loss held is set out below. An analysis of trading and other financial assets at fair value through profit or loss is included in note 13 and a similar analysis for available-for-sale financial assets is included in note 21. The Group's non-participating investment contracts are all unit-linked. Trading and other financial assets at fair value through profit or loss which back those investment contracts, including movements arising from credit risk, are borne by the contract holders.

Derivative assets – the Group reduces exposure to credit risk by using master netting agreements and by obtaining cash collateral. An analysis of derivative assets is given in note 14. Of the net derivative assets of £17,042 million for the Group and £16,182 million for the Bank (2008: £18,286 million for the Group and £16,106 million for the Bank), cash collateral of £2,029 million (2008: £2,970 million) was held for both the Group and the Bank, and a further £11,889 million for the Group and £10,748 million for the Bank was due from OECD banks (2008: £5,840 million for the Group and £3,574 million for the Bank).

Assets arising from reinsurance contracts held – of the assets arising from reinsurance contracts held at 31 December 2009 of £419 million (2008: £385 million), £225 million (2008: £380 million) were due from insurers with a credit rating of AA or above.

Financial guarantees – these represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

Reverse repo and repo transactions – for reverse repo transactions which are accounted for as collateralised loans, it is the Group's policy to seek collateral which is at least equal to the amount loaned. At 31 December 2009, the fair value of collateral accepted under reverse repo transactions that the Group and the Bank is permitted by contract or custom to sell or repledge was £5,270 million (2008: £5,858 million). Of this, £5,270 million (2008: £5,855 million) for the Group and the Bank was sold or repledged as at 31 December 2009. The fair value of collateral pledged in respect of repo transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to sell or repledge was £14,222 million (2008: £5,734 million) for the Group and the Bank.

51 Financial risk management (continued)

Loans and advances – The Group

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2009						
Neither past due nor impaired	**25,428**	**110,523**	**31,651**	**77,590**	**219,764**	**439**
Past due but not impaired	**–**	**2,794**	**1,067**	**413**	**4,274**	**–**
Impaired – no provision required	**–**	**519**	**423**	**1,588**	**2,530**	**–**
– provision held	**153**	**1,513**	**4,465**	**3,305**	**9,283**	**–**
Gross	**25,581**	**115,349**	**37,606**	**82,896**	**235,851**	**439**
Allowance for impairment losses (note 20)	**(149)**	**(362)**	**(2,629)**	**(1,822)**	**(4,813)**	**–**
Net	**25,432**	**114,987**	**34,977**	**81,074**	**231,038**	**439**
Due from fellow Lloyds Banking Group undertakings	**150,122**				**14,188**	**–**
	175,554				**245,226**	**439**

No impairment allowances have been raised in respect of amounts due from fellow Lloyds Banking Group undertakings.

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2008						
Neither past due nor impaired	38,716	110,148	33,571	86,707	230,426	608
Past due but not impaired	17	3,134	1,146	555	4,835	–
Impaired – no provision required	–	479	150	1,253	1,882	–
– provision held	135	882	4,327	1,451	6,660	–
Gross	38,868	114,643	39,194	89,966	243,803	608
Allowance for impairment losses (note 20)	(135)	(186)	(2,345)	(928)	(3,459)	–
Net	38,733	114,457	36,849	89,038	240,344	608

No amounts were due from fellow Lloyds Banking Group undertakings at 31 December 2008.

The analysis of lending between retail and wholesale has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within wholesale are exposures to corporate customers and other large institutions.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 3. All impaired loans which exceed certain thresholds, principally within the Group's wholesale and corporate businesses, are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security. Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £4,869 million (2008: £2,699 million) which have associated collateral with a fair value of £661 million (2008: £518 million).

51 Financial risk management (continued)

Loans and advances which are neither past due nor impaired – The Group

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
Good quality	**25,261**	**107,205**	**20,401**	**41,210**		**58**
Satisfactory quality	**141**	**3,318**	**8,441**	**27,668**		**268**
Lower quality	**14**	**–**	**848**	**7,931**		**90**
Below standard, but not impaired	**12**	**–**	**1,961**	**781**		**23**
Total	**25,428**	**110,523**	**31,651**	**77,590**	**219,764**	**439**
31 December 2008						
Good quality	38,283	109,815	21,373	49,349		129
Satisfactory quality	215	264	9,192	31,042		411
Lower quality	204	–	900	5,831		56
Below standard, but not impaired	14	69	2,106	485		12
Total	38,716	110,148	33,571	86,707	230,426	608

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models. Good quality lending includes the lower assessed default probabilities and all loans with low expected losses in the event of default, with other categories reflecting progressively higher risks and lower expected recoveries.

Loans and advances which are past due but not impaired – The Group

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
0-30 days	**–**	**1,325**	**812**	**228**	**2,365**	**–**
30-60 days	**–**	**562**	**226**	**37**	**825**	**–**
60-90 days	**–**	**365**	**27**	**86**	**478**	**–**
90-180 days	**–**	**541**	**1**	**21**	**563**	**–**
Over 180 days	**–**	**1**	**1**	**41**	**43**	**–**
Total	**–**	**2,794**	**1,067**	**413**	**4,274**	**–**
Fair value of collateral held		**2,396**	**n/a**	**n/a**	**n/a**	
31 December 2008						
0-30 days	–	1,527	853	289	2,669	–
30-60 days	–	633	259	90	982	–
60-90 days	17	424	32	70	526	–
90-180 days	–	549	2	77	628	–
Over 180 days	–	1	–	29	30	–
Total	17	3,134	1,146	555	4,835	–
Fair value of collateral held		2,637	n/a	n/a	n/a	

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Group's credit exposure.

Lending decisions are based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values for non-mortgage lending are assessed more rigorously at the time of loan origination or when taking enforcement action and may fluctuate, as in the case of floating charges, according to the level of assets held by the customer. Whilst collateral is reviewed on a regular basis in accordance with business unit credit policy, this varies according to the type of lending and collateral involved. It is therefore not practicable to estimate and aggregate current fair values of collateral for non-mortgage lending.

51 Financial risk management (continued)

Loans and advances – The Bank

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2009						
Neither past due nor impaired	**8,338**	**97,345**	**23,666**	**61,515**	**182,526**	**439**
Past due but not impaired	**–**	**2,640**	**732**	**373**	**3,745**	**–**
Impaired – no provision required	**–**	**490**	**280**	**1,535**	**2,305**	**–**
– provision held	**153**	**1,447**	**3,033**	**2,958**	**7,438**	**–**
Gross	**8,491**	**101,922**	**27,711**	**66,381**	**196,014**	**439**
Allowance for impairment losses (note 20)	**(149)**	**(338)**	**(1,642)**	**(1,615)**	**(3,595)**	**–**
Net	**8,342**	**101,584**	**26,069**	**64,766**	**192,419**	**439**
Due from fellow Lloyds Banking Group undertakings	**168,214**				**60,692**	**–**
Total	**176,556**				**253,111**	**439**

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2008						
Neither past due nor impaired	25,606	97,016	25,299	68,110	190,425	608
Past due but not impaired	17	2,850	860	526	4,236	–
Impaired – no provision required	–	345	125	1,232	1,702	–
– provision held	158	714	3,331	1,368	5,413	–
Gross	25,781	100,925	29,615	71,236	201,776	608
Allowance for impairment losses (note 20)	(135)	(175)	(1,692)	(833)	(2,700)	–
Net	25,646	100,750	27,923	70,403	199,076	608
Due from fellow Lloyds Banking Group undertakings	11,322				50,287	–
Total	36,968				249,363	608

No impairment allowances have been raised in respect of amounts due from fellow Lloyds Banking Group undertakings.

Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £4,440 million (2008: £2,559 million) which have associated collateral with a fair value of £361 million (2008: £420 million).

51 Financial risk management (continued)

Loans and advances which are neither past due nor impaired – The Bank

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
Good quality	**8,173**	**94,225**	**14,779**	**32,429**		**58**
Satisfactory quality	**141**	**3,120**	**6,632**	**23,442**		**268**
Lower quality	**12**	**–**	**789**	**5,076**		**90**
Below standard, but not impaired	**12**	**–**	**1,466**	**568**		**23**
Total	**8,338**	**97,345**	**23,666**	**61,515**	**182,526**	**439**
31 December 2008						
Good quality	25,372	96,749	14,805	38,325		129
Satisfactory quality	185	267	7,897	27,769		411
Lower quality	35	–	867	1,771		56
Below standard, but not impaired	14	–	1,730	245		12
Total	25,606	97,016	25,299	68,110	190,425	608

Loans and advances which are past due but not impaired – The Bank

	Loans and advances to banks £m	Loans and advances to customers: Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
0-30 days	**–**	**1,267**	**489**	**196**	**1,952**	**–**
30-60 days	**–**	**520**	**218**	**30**	**768**	**–**
60-90 days	**–**	**345**	**24**	**85**	**454**	**–**
90-180 days	**–**	**508**	**1**	**21**	**530**	**–**
Over 180 days	**–**	**–**	**–**	**41**	**41**	**–**
Total	**–**	**2,640**	**732**	**373**	**3,745**	**–**
Fair value of collateral held		**2,262**	**n/a**	**n/a**	**n/a**	
31 December 2008						
0-30 days	–	1,332	578	261	2,171	–
30-60 days	–	583	248	90	921	–
60-90 days	17	404	32	69	505	–
90-180 days	–	530	2	77	609	–
Over 180 days	–	1	–	29	30	–
Total	17	2,850	860	526	4,236	–
Fair value of collateral held		2,422	n/a	n/a	n/a	

Renegotiated loans and advances

Loans and advances that were renegotiated during the year and that would otherwise have been past due or impaired at 31 December 2009 totalled £217 million (2008: £144 million) for the Group and £209 million (2008: £133 million) for the Bank.

Repossessed collateral	The Group 2009 £m	The Group 2008 £m	The Bank 2009 £m	The Bank 2008 £m
Residential property	**210**	221	**193**	210
Other	**684**	26	**–**	–
Total	**894**	247	**193**	210

In respect of retail portfolios, the Group does not normally take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

In certain circumstances, the Group takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policy.

51 Financial risk management (continued)

Loan-to-value ratio of mortgage lending	The Group 2009 £m	The Group 2008 £m	The Bank 2009 £m	The Bank 2008 £m
Analysis by loan-to-value ratio of residential mortgage lending which is neither past due nor impaired:				
Less than 70 per cent	**53,100**	55,040	**47,454**	49,086
70 per cent to 80 per cent	**16,865**	15,812	**15,035**	14,079
80 per cent to 90 per cent	**15,061**	15,954	**13,370**	14,186
Greater than 90 per cent	**25,497**	23,342	**21,486**	19,665
Total	**110,523**	110,148	**97,345**	97,016

Debt securities, treasury and other bills – analysis by credit rating

The Group

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2009							
Debt securities held at fair value through profit or loss							
Trading assets							
Government securities	42	–	–	–	–	30	72
Other public sector securities	–	–	6	–	–	–	6
Corporate and other debt securities	25	12	1	65	44	12	159
Total held as trading assets	67	12	7	65	44	42	237
Other assets held at fair value through profit or loss							
Government securities	7,497	139	182	2	–	46	7,866
Other public sector securities	25	–	–	–	–	9	34
Asset-backed securities:							
Mortgage-backed securities	199	127	43	23	–	1	393
Other asset-backed securities	254	294	536	302	250	20	1,656
	453	421	579	325	250	21	2,049
Corporate and other debt securities	2,549	582	2,933	2,416	604	1,328	10,412
Total other assets held at fair value through profit or loss	10,524	1,142	3,694	2,743	854	1,404	20,368
Total held at fair value through profit or loss	10,591	1,154	3,701	2,808	898	1,446	20,598
Available-for-sale financial assets							
Debt securities							
Government securities	8,192	–	1	–	–	149	8,342
Other public sector securities	–	–	–	–	–	31	31
Bank and building society certificates of deposit	–	357	353	–	19	–	729
Asset-backed securities:							
Mortgage-backed securities	3,803	555	215	156	35	–	4,764
Other asset-backed securities	6,011	721	448	179	186	16	7,561
	9,814	1,276	663	335	221	16	12,325
Corporate and other debt securities	9	637	292	–	–	165	1,103
Total debt securities	18,015	2,270	1,309	335	240	361	22,530
Treasury bills and other bills	269	2,263	–	–	–	–	2,532
Total held as available-for-sale assets	18,284	4,533	1,309	335	240	361	25,062
Due from fellow Group undertakings:							
Corporate and other debt securities							946
							26,008
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	231	52	39	39	83	156	600
Other asset-backed securities	26	71	6	1	209	–	313
	257	123	45	40	292	156	913
Corporate and other debt securities	–	439	823	69	306	331	1,968
Total debt securities classified as loans and receivables	257	562	868	109	598	487	2,881

51 Financial risk management (continued)

Debt securities, treasury and other bills – analysis by credit rating

The Group

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2008							
Debt securities held at fair value through profit or loss							
Trading assets							
Government securities	38	–	–	–	–	–	38
Corporate and other debt securities	76	187	38	68	87	80	536
Total held as trading assets	114	187	38	68	87	80	574
Other assets held at fair value through profit or loss							
Government securities	7,025	45	138	1	–	117	7,326
Other public sector securities	–	–	–	–	–	18	18
Bank and building society certificates of deposit	96	337	–	–	–	–	433
Asset-backed securities:							
Mortgage-backed securities	207	108	23	16	–	15	369
Other asset-backed securities	206	362	391	277	105	1	1,342
	413	470	414	293	105	16	1,711
Corporate and other debt securities	3,194	864	2,911	2,142	599	1,410	11,120
Total other assets at fair value through profit or loss	10,728	1,716	3,463	2,436	704	1,561	20,608
Total held at fair value through profit or loss	10,842	1,903	3,501	2,504	791	1,641	21,182
Available-for-sale financial assets							
Debt securities							
Government securities	851	–	1	–	–	16	868
Other public sector securities	–	–	–	–	–	12	12
Bank and building society certificates of deposit	–	9,418	166	–	18	–	9,602
Asset-backed securities:							
Mortgage-backed securities	5,523	59	59	18	41	–	5,700
Other asset-backed securities	7,412	235	134	73	184	54	8,092
	12,935	294	193	91	225	54	13,792
Corporate and other debt securities	168	1,257	192	–	–	566	2,183
Total debt securities	13,954	10,969	552	91	243	648	26,457
Treasury bills and other bills	26,858	2,351	–	–	–	–	29,209
Total held as available-for-sale assets	40,812	13,320	552	91	243	648	55,666
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	431	6	–	31	10	–	478
Other asset-backed securities	73	72	162	53	10	170	540
	504	78	162	84	20	170	1,018
Corporate and other debt securities	18	1,204	1,663	114	–	532	3,531
Total debt securities classified as loans and receivables	522	1,282	1,825	198	20	702	4,549

There are no material amounts for debt securities, treasury and other bills which are past due but not impaired.

51 Financial risk management (continued)

Debt securities, treasury and other bills – analysis by credit rating

The Bank

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2009							
Debt securities held at fair value through profit or loss							
Trading assets							
Government securities	42	–	–	–	–	30	72
Other public sector securities	–	–	6	–	–	–	6
Corporate and other debt securities	25	12	1	65	44	12	159
Total held as trading assets	67	12	7	65	44	42	237
Other assets held at fair value through profit or loss							
Other asset-backed securities	44	–	–	–	203	–	247
Corporate and other debt securities	–	–	141	788	481	296	1,706
Total other assets held at fair value through profit or loss	44	–	141	788	684	296	1,953
Total held at fair value through profit or loss	111	12	148	853	728	338	2,190
Available-for-sale financial assets							
Debt securities							
Government securities	8,192	–	1	–	–	7	8,200
Other public sector securities	–	–	–	–	–	31	31
Bank and building society certificates of deposit	–	356	93	–	14	–	463
Asset-backed securities:							
Mortgage-backed securities	790	205	59	25	1	–	1,080
Other asset-backed securities	1,686	178	60	65	117	16	2,122
	2,476	383	119	90	118	16	3,202
Corporate and other debt securities	9	637	292	–	–	23	961
Total debt securities	10,677	1,376	505	90	132	77	12,857
Treasury bills and other bills	71	–	–	–	–	–	71
Total held as available-for-sale assets	10,748	1,376	505	90	132	77	12,928
Due from fellow Group undertakings:							
Corporate and other debt securities							510
							13,438
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	231	52	39	39	73	156	590
Other asset-backed securities	26	110	92	81	209	–	518
	257	162	131	120	282	156	1,108
Corporate and other debt securities	–	439	823	69	306	330	1,967
Total debt securities classified as loans and receivables	257	601	954	189	588	486	3,075

51 Financial risk management (continued)

Debt securities, treasury and other bills – analysis by credit rating

The Bank

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2008							
Debt securities held at fair value through profit or loss							
Trading assets							
Government securities	38	–	–	–	–	–	38
Corporate and other debt securities	76	187	38	68	87	80	536
Total held as trading assets	114	187	38	68	87	80	574
Other assets held at fair value through profit or loss							
Other asset-backed securities	–	–	–	–	105	–	105
Corporate and other debt securities	41	77	286	1,089	553	341	2,387
Total other assets held at fair value through profit or loss	41	77	286	1,089	658	341	2,492
Total held at fair value through profit or loss	155	264	324	1,157	745	421	3,066
Available-for-sale financial assets							
Debt securities							
Government securities	501	–	1	–	–	8	510
Other public sector securities	–	–	–	–	–	12	12
Bank and building society certificates of deposit	–	7,484	166	–	13	–	7,663
Asset-backed securities:							
Mortgage-backed securities	1,383	15	3	13	32	–	1,446
Other asset-backed securities	2,449	60	24	62	184	52	2,831
	3,832	75	27	75	216	52	4,277
Corporate and other debt securities	29	312	–	–	14	159	514
Total debt securities	4,362	7,871	194	75	243	231	12,976
Treasury bills and other bills	26,857	–	–	–	–	–	26,857
Total held as available-for-sale assets	31,219	7,871	194	75	243	231	39,833
Due from fellow Group undertakings							
Mortgage-backed securities							17,830
Other asset-backed securities							745
							58,408
Debt securities classified as loans and receivables							
Asset-backed securities	73	72	162	53	10	170	540
Corporate and other debt securities	18	1,204	1,663	114	–	457	3,456
Total debt securities classified as loans and receivables	91	1,276	1,825	167	10	627	3,996

Credit market exposures

The Group's credit market exposures primarily relate to asset-backed securities held in the non-retail businesses. These exposures are classified as loans and receivables (note 19), available-for-sale (note 21) and trading and other financial assets at fair value through profit or loss (note 13) depending on the nature of the investment.

51 Financial risk management (continued)

The Group

	Loans and receivables £m	Available-for-sale £m	Trading and other financial assets at fair value through profit or loss £m	Net exposure as at 31 December 2009 £m	Net exposure as at 31 December 2008 £m
Asset-backed securities					
US residential mortgage-backed securities	336	–	–	336	488
Non-US residential mortgage-backed securities	–	3,559	–	3,559	4,585
Commercial mortgage-backed securities	27	1,176	–	1,203	1,328
	363	4,735	–	5,098	6,401
Collateralised debt obligations					
Collateralised debt obligations	106	45	–	151	189
Collateralised loan obligations	151	1,739	–	1,890	2,319
	257	1,784	–	2,041	2,508
Personal sector					
Auto loans	–	724	–	724	796
Credit cards	–	770	–	770	1,126
Personal loans	–	230	–	230	39
	–	1,724	–	1,724	1,961
Federal Family Education Loan Program student loans	–	3,306	–	3,306	2,951
Other asset-backed securities	–	776	–	776	1,050
Total uncovered asset-backed securities	620	12,325	–	12,945	14,871
Negative basis[1]	–	–	283	283	584
Total asset-backed securities	620	12,325	283	13,228	15,455
Direct	605	6,943	283	7,831	8,728
Conduits	15	5,382	–	5,397	6,727
Total wholesale asset-backed securities	620	12,325	283	13,228	15,455
Other asset-backed securities	293	–	1,766	2,052	1,066
Total asset-backed securities	913	12,325	2,049	15,280	16,521

[1] Negative basis means bonds held with separate matching credit default swap protection.

The table below details the direct exposure to Non-US residential mortgage-backed securities by vintage:

The Group

	Pre-2005 £m	2005 £m	2006 £m	2007 £m	Net exposure as at 31 December 2009 £m	Net exposure as at 31 December 2008 £m
Asset class						
Prime	–	–	11	4	15	–
Alt-A	–	1	110	210	321	488
Sub-prime	–	–	–	–	–	–
Total	–	1	121	214	336	488

51 Financial risk management (continued)

Exposure to monolines

During the year all exposure to sub-investment grade monolines on credit default swap contracts was written down to zero, leaving limited exposure to monoline insurers set out below.

The Group	Credit Default Swaps		Wrapped loans and receivables		Wrapped bonds	
	Notional £m	Exposure[1] £m	Notional £m	Exposure[2] £m	Notional £m	Exposure[3] £m
Investment grade	–	–	**401**	**260**	**4**	**3**
Sub-investment grade	–	–	–	–	**10**	**1**
Total	–	–	**401**	**260**	**14**	**4**

[1]The exposure to monolines arising from credit default swaps is calculated as the mark-to-market of the credit default swap protection purchased from the monoline after credit valuation adjustments.

[2]The exposure to monolines on wrapped loans and receivables and bonds is the internal assessment of amounts that will be recovered from the monoline guarantor on interest and principal shortfalls.

[3]In addition, the Group has £1,196 million of monoline wrapped bonds and £791 million of monoline liquidity commitments on which the Group currently places no reliance on the guarantor.

Credit ratings

An analysis of external credit ratings as at 31 December 2009 of the asset-backed securities portfolio by asset class is provided below. These ratings are based on the lowest of Moody's, Standard & Poor's and Fitch.

The Group	Net exposure £m	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Below B £m
Asset-class								
Mortgage-backed securities								
US residential mortgage-backed securities:								
Prime	**15**	–	**4**	–	–	–	**4**	**7**
Alt-A	**321**	**230**	**45**	**15**	**15**	**11**	**2**	**3**
Sub Prime	–	–	–	–	–	–	–	–
	336	**230**	**49**	**15**	**15**	**11**	**6**	**10**
Non-US residential mortgage-backed securities	**3,559**	**3,359**	**200**	–	–	–	–	–
Commercial mortgage-backed securities	**1,203**	**395**	**380**	**216**	**166**	**14**	–	**32**
	5,098	**3,984**	**629**	**231**	**181**	**25**	**6**	**42**
Collateralised debt obligations								
Collateralised debt obligations	**152**	–	**107**	–	–	–	–	**45**
Collateralised loan obligations	**1,889**	**904**	**614**	**190**	**111**	**45**	**18**	**7**
	2,041	**904**	**721**	**190**	**111**	**45**	**18**	**52**
Personal sector								
Auto loans	**724**	**693**	**7**	–	–	**24**	–	–
Credit cards	**770**	**770**	–	–	–	–	–	–
Personal loans	**230**	**196**	**22**	**12**	–	–	–	–
	1,724	**1,659**	**29**	**12**	–	**24**	–	–
Federal family education loan program student loans	**3,306**	**3,215**	**91**	–	–	–	–	–
Other asset-backed securities	**783**	**268**	**1**	**313**	**112**	**74**	**15**	–
Total uncovered asset-backed securities	**12,952**	**10,030**	**1,471**	**746**	**404**	**168**	**39**	**95**
Negative basis[1]								
Monolines	**79**	–	–	**79**	–	–	–	–
Banks	**204**	–	–	–	–	–	–	**204**
Total as at 31 December 2009	**13,235**	**10,030**	**1,471**	**825**	**404**	**168**	**39**	**298**
Total as at 31 December 2008	15,455	13,518	436	131	260	–	–	1,110

[1]The external credit rating is based on the bond ignoring the benefit of the credit default swap.

51 Financial risk management (continued)

(2) Market Risk
Interest rate risk
In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There are a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio.

At 31 December 2009 the aggregate notional principal of interest rate swaps designated as fair value hedges was £24,219 million (2008: £37,243 million) for the Group and £23,219 million (2008: £38,243 million) for the Bank with a net fair value asset of £458 million (2008: liability of £1,231 million) for the Group and £370 million (2008: liability of £1,438 million) for the Bank (note 14). The losses recognised by the Group on the hedging instruments were £4 million (2008: losses of £584 million). The Group's gains on the hedged items attributable to the hedged risk were £26 million (2008: gains of £426 million).

In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next six years and the hedge accounting adjustments will be reported in the income statement as the cash flows arise. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2009 was £659 million (2008: £867 million) for the Group and the Bank with a net fair value liability of £46 million (2008: £90 million) for the Group and the Bank (note 14). In 2009, there is no ineffectiveness recognised in the Group's income statement that arises from cash flow hedges (2008: £nil). There were no transactions for which cash flow hedge accounting had to be ceased in 2009 or 2008 as a result of the highly probable cash flows no longer being expected to occur.

Currency risk
Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the central market risk function.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the net investments in certain foreign operations using cross currency swaps. At 31 December 2009 the notional principal of these cross currency swaps was £2,507 million with a net fair value asset of £25 million (2008: notional principal £6,318 million with a net fair value liability of £2,413 million) (note 14) and they were designated on an after-tax basis as hedges of net investments in foreign operations. In 2009 ineffectiveness of £nil before tax and £nil after tax (2008: £14 million before tax and £10 million after tax) was recognised in the income statement arising from net investment hedges.

The Group's main overseas operations are in the Americas, Asia and Europe. Details of the Group's structural foreign currency exposures are, after net investment hedges, as follows:

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Functional currency of Group operations:				
Euro	**113**	133	**62**	82
US dollar	**(122)**	(907)	**81**	90
Swiss franc:				
Gross exposure	**2,552**	2,784	**51**	78
Net investment hedge	**(2,467)**	(2,663)	**–**	–
	85	121	**51**	78
Japanese yen:				
Gross exposure	**3,220**	3,667	**12**	16
Net investment hedge	**(3,207)**	(3,645)	**–**	–
	13	22	**12**	16
Other non-sterling	**318**	296	**281**	258
	407	(335)	**487**	524

51 Financial risk management (continued)

(3) Liquidity risk

The tables below analyse financial instrument liabilities of the Group and the Bank, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

The Group	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009						
Deposits from banks	**76,070**	**51,297**	**11,852**	**327**	**455**	**140,001**
Customer deposits	**152,423**	**8,554**	**9,844**	**9,438**	**13,412**	**193,671**
Trading and other financial liabilities at fair value through profit or loss	**716**	**141**	**1,582**	**3,222**	**1,275**	**6,936**
Debt securities in issue	**26,315**	**26,187**	**16,281**	**49,460**	**5,869**	**124,112**
Liabilities arising from non-participating investment contracts	**15,734**	**–**	**–**	**–**	**–**	**15,734**
Subordinated liabilities	**151**	**70**	**623**	**4,659**	**18,012**	**23,515**
Total	**271,409**	**86,249**	**40,182**	**67,106**	**39,023**	**503,969**
Gross settled derivatives – outflows	**4,907**	**943**	**365**	**122**	**986**	**7,323**
Gross settled derivatives – inflows	**(901)**	**(607)**	**(189)**	**(157)**	**(385)**	**(2,239)**
Gross settled derivatives – net flows	**4,006**	**336**	**176**	**(35)**	**601**	**5,084**
Net settled derivative liabilities	**14,817**	**–**	**–**	**–**	**–**	**14,817**
Total derivative financial liabilities	**18,823**	**336**	**176**	**(35)**	**601**	**19,901**
As at 31 December 2008						
Deposits from banks	49,620	13,617	1,480	1,986	5	66,708
Customer deposits	158,607	8,482	9,788	2,322	830	180,029
Trading and other financial liabilities at fair value through profit or loss	30,776	1,077	5,295	7,203	3,818	48,169
Debt securities in issue	24,306	26,932	6,591	13,643	3,489	74,961
Liabilities arising from non-participating investment contracts	14,243	–	–	–	–	14,243
Subordinated liabilities	20	102	438	4,593	17,987	23,140
Total	277,572	50,210	23,592	29,747	26,129	407,250
Gross settled derivatives – outflows	5,210	284	4,602	990	1,154	12,240
Gross settled derivatives – inflows	(3,136)	(33)	(3,248)	–	–	(6,417)
Gross settled derivatives – net flows	2,074	251	1,354	990	1,154	5,823
Net settled derivative liabilities	1,824	640	415	350	970	4,199
Total derivative financial liabilities	3,898	891	1,769	1,340	2,124	10,022

Cash flows for undated subordinated liabilities whose terms give the Group the option to redeem at a future date are included within the table on the basis that the Group will exercise its option to redeem.

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £216 million (2008: £300 million) per annum for the Group and the Bank which is payable in respect of those instruments for as long as they remain in issue (i.e. in perpetuity) is not included beyond 5 years.

51 Financial risk management (continued)

The Bank	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009						
Deposits from banks	**87,385**	**57,981**	**12,960**	**3,625**	**3,837**	**165,788**
Customer deposits	**146,010**	**9,668**	**18,774**	**14,463**	**13,905**	**202,820**
Trading and other financial liabilities at fair value through profit or loss	**716**	**141**	**1,582**	**3,222**	**1,275**	**6,936**
Debt securities in issue	**21,533**	**23,315**	**16,205**	**46,354**	**5,641**	**113,048**
Subordinated liabilities	**144**	**81**	**595**	**4,544**	**17,519**	**22,883**
Total	**255,788**	**91,186**	**50,116**	**72,208**	**42,177**	**511,475**
Gross settled derivatives – outflows	**4,244**	**368**	**227**	**126**	**686**	**5,651**
Gross settled derivatives – inflows	**–**	**(1)**	**(120)**	**(442)**	**(364)**	**(927)**
Gross settled derivatives – net flows	**4,244**	**367**	**107**	**(316)**	**322**	**4,724**
Net settled derivative liabilities	**15,021**	**–**	**–**	**–**	**–**	**15,021**
Total derivative financial liabilities	**19,265**	**367**	**107**	**(316)**	**322**	**19,745**
As at 31 December 2008						
Deposits from banks	61,342	14,675	2,203	2,579	–	80,799
Customer deposits	146,168	9,689	19,758	8,498	2,122	186,235
Trading and other financial liabilities at fair value through profit or loss	27,912	425	1,210	7,051	3,573	40,171
Debt securities in issue	16,100	22,206	10,561	23,605	3,263	75,735
Subordinated liabilities	21	102	409	4,479	17,432	22,443
Total	251,543	47,097	34,141	46,212	26,390	405,383
Gross settled derivatives – outflows	5,214	292	4,640	1,188	1,880	13,214
Gross settled derivatives – inflows	(3,136)	(33)	(3,248)	–	–	(6,417)
Total derivative financial liabilities	2,078	259	1,392	1,188	1,880	6,797

Liabilities of the Group arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	1-2 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2009	**485**	**1,203**	**1,895**	**7,983**	**25,394**	**36,960**
As at 31 December 2008	340	927	2,626	7,030	22,904	33,827

51 Financial risk management (continued)

The following tables set out the amounts and residual maturities of off balance sheet contingent liabilities and commitments.

The Group

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2009					
Acceptances	**53**	**–**	**–**	**–**	**53**
Other contingent liabilities	**2,181**	**1,302**	**379**	**825**	**4,687**
Total contingent liabilities	**2,234**	**1,302**	**379**	**825**	**4,740**
Lending commitments	**46,662**	**17,205**	**7,253**	**2,408**	**73,528**
Other commitments	**866**	**105**	**–**	**6**	**977**
Total commitments	**47,528**	**17,310**	**7,253**	**2,414**	**74,505**
Total contingents and commitments	**49,762**	**18,612**	**7,632**	**3,239**	**79,245**
31 December 2008					
Acceptances	49	–	–	–	49
Other contingent liabilities	1,722	1,525	402	1,071	4,720
Total contingent liabilities	1,771	1,525	402	1,071	4,769
Lending commitments	54,155	15,029	8,014	3,625	80,823
Other commitments	572	181	80	99	932
Total commitments	54,727	15,210	8,094	3,724	81,755
Total contingents and commitments	56,498	16,735	8,496	4,795	86,524

The Bank

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2009					
Acceptances	**54**	**–**	**–**	**–**	**54**
Other contingent liabilities	**1,537**	**1,292**	**379**	**840**	**4,048**
Total contingent liabilities	**1,591**	**1,292**	**379**	**840**	**4,102**
Lending commitments	**53,007**	**16,439**	**6,836**	**2,079**	**78,361**
Other commitments	**3,481**	**105**	**–**	**6**	**3,592**
Total commitments	**56,488**	**16,544**	**6,836**	**2,085**	**81,953**
Total contingents and commitments	**58,079**	**17,836**	**7,215**	**2,925**	**86,055**
31 December 2008					
Acceptances	49	–	–	–	49
Other contingent liabilities	1,631	1,522	402	1,089	4,644
Total contingent liabilities	1,680	1,522	402	1,089	4,693
Lending commitments	64,095	14,613	7,704	3,290	89,702
Other commitments	673	182	81	100	1,036
Total commitments	64,768	14,795	7,785	3,390	90,738
Total contingents and commitments	66,448	16,317	8,187	4,479	95,431

52 Capital

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the Lloyds Banking Group Asset and Liability Committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight.

The Group's regulatory capital is divided into tiers defined by the European Community Banking Consolidation Directive as implemented in the UK by the Financial Services Authority's (FSA) General Prudential Sourcebook. Tier 1 capital comprises mainly shareholders' equity, tier 1 capital instruments and minority interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected losses over accounting provisions and certain securitisation positions. During the year the FSA has defined Core Tier 1 capital. Accounting equity is adjusted in accordance with FSA requirements, particularly in respect of pensions and available-for-sale assets. Tier 2 capital mainly comprises qualifying subordinated debt after deducting 50 per cent of the excess of expected losses over accounting provisions, and certain securitisation positions. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. Total capital is reduced by deducting investments in subsidiaries and associates that are not consolidated for regulatory purposes. In the case of the Lloyds TSB Bank Group, this means that the net assets of its life assurance and general insurance businesses are excluded from its total regulatory capital.

	2009 £m	2008 £m
Tier 1 capital	**18,307**	13,574
Tier 2 capital	**7,677**	10,437
	25,984	24,011
Supervisory deductions	**(5,182)**	(4,758)
Total capital	**20,802**	19,253

A number of limits are imposed by the FSA on the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

The FSA sets Individual Capital Guidance ('ICG') for each UK bank calibrated by reference to its Capital Resources Requirement ('CRR'), broadly equivalent to 8 per cent of risk-weighted assets and thus representing the capital required under Pillar 1 of the Basel II framework. Also a key input into the FSA's ICG setting process, (which addresses the requirements of Pillar 2 of the Basel II framework), is each bank's Internal Capital Adequacy Assessment Process. The FSA's approach is to monitor the available capital resources in relation to the ICG requirement. The Group has been given ICG by the FSA and the board has also agreed a formal buffer to be maintained in addition to this requirement. Any breaches of the formal buffer must be notified to the FSA, together with proposed remedial action. The FSA has made it clear that each ICG remains a confidential matter between each bank and the FSA.

During the year, the individual entities within the Group and the Group complied with all of the externally imposed capital requirements to which they are subject.

53 Cash flow statements

a Change in operating assets

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Change in loans and receivables	**(149,606)**	(33,717)	**(155,255)**	(46,849)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**6,473**	(8,827)	**9,767**	(15,191)
Change in other operating assets	**228**	(298)	**1,578**	(264)
Change in operating assets	**(142,905)**	(42,842)	**(143,910)**	(62,304)

b Change in operating liabilities

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Change in deposits from banks	**73,678**	25,279	**80,534**	29,445
Change in customer deposits	**21,046**	14,356	**17,377**	19,501
Change in debt securities in issue	**47,238**	21,501	**53,469**	36,175
Change in derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	**(11,835)**	23,693	**(13,282)**	24,620
Change in investment contract liabilities	**2,982**	(3,061)	**–**	–
Change in other operating liabilities	**(674)**	681	**(1,440)**	659
Change in operating liabilities	**132,435**	82,449	**136,658**	110,400

53 Cash flow statements (continued)

c Non-cash and other items

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Depreciation and amortisation	**733**	686	**339**	317
Revaluation of investment properties	**145**	1,058	**–**	–
Allowance for loan losses	**4,353**	2,876	**3,635**	2,472
Write-off of allowance for loan losses	**(2,786)**	(1,498)	**(2,512)**	(1,294)
Impairment of available-for-sale securities	**21**	130	**16**	130
Impairment of goodwill	**240**	100	**–**	–
Permanent diminution in value of subsidiaries	**–**	–	**–**	20
Change in insurance contract liabilities	**3,173**	(4,649)	**–**	–
Customer remediation paid	**(5)**	(9)	**(4)**	(8)
Other provision movements	**159**	16	**163**	45
Net charge in respect of defined benefit schemes	**275**	164	**213**	127
Contributions to defined benefit schemes	**(1,574)**	(547)	**(1,438)**	(406)
Other non-cash items	**(1,028)**	(3,743)	**(1,839)**	2,262
Total non-cash items	**3,706**	(5,416)	**(1,427)**	3,665
Interest expense on subordinated liabilities	**984**	901	**956**	822
Other	**(7)**	(10)	**24**	(14)
Total other items	**977**	891	**980**	808
Non-cash and other items	**4,683**	(4,525)	**(447)**	4,473

d Analysis of cash and cash equivalents as shown in the balance sheet

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Cash and balances with central banks	**36,089**	5,008	**35,964**	4,890
Less: mandatory reserve deposits[1]	**(392)**	(545)	**(372)**	(530)
	35,697	4,463	**35,592**	4,360
Loans and advances to banks	**175,554**	40,758	**176,556**	36,968
Less: amounts with a maturity of three months or more and balances due from fellow Lloyds Banking Group undertakings	**(154,645)**	(12,461)	**(169,941)**	(18,904)
	20,909	28,297	**6,615**	18,064
	56,606	32,760	**42,207**	22,424

[1]Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents of the Group at 31 December 2009 is £10,358 million (2008: £8,255 million) held within the Group's life funds, which is not immediately available for use in the business.

53 Cash flow statements (continued)

e Analysis of changes in financing during the year

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Share capital (including share premium account):				
At 1 January	**4,502**	4,502	**4,502**	4,502
Issue of ordinary shares	**5,600**	–	**5,600**	–
At December	**10,102**	4,502	**10,102**	4,502

	The Group	
	2009 £m	2008 £m
Minority interests:		
At 1 January	**306**	284
Exchange and other adjustments	**(19)**	28
Repayment of capital to minority shareholders	**–**	(3)
Minority share of profit after tax	**24**	26
Dividends paid to minority shareholders	**(18)**	(29)
At 31 December	**293**	306

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Subordinated liabilities				
At 1 January	**17,389**	12,437	**16,853**	11,903
Exchange and other adjustments	**(2,735)**	2,312	**(2,742)**	2,310
Proceeds from issue of subordinated liabilities	**3,187**	3,021	**3,187**	3,021
Repayments of subordinated liabilities	**(1,842)**	(381)	**(1,842)**	(381)
At 31 December	**15,999**	17,389	**15,456**	16,853

f Acquisition of group undertakings and businesses

	The Group		The Bank	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Net cash outflow from acquisitions in the year – investments in subsidiaries	**–**	–	**1**	817
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**35**	19	**–**	–
Net cash outflow from acquisitions	**35**	19	**1**	817

g Disposal of group undertakings and businesses
The Bank generated inflows of £33 million (2008: £187 million) from the disposal and liquidation of subsidiary undertakings.

54 Future accounting developments

The following pronouncements will be relevant to the Group but were not effective at 31 December 2009 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group, with the exception of IFRS 9 'Financial Instruments: Classification and Measurement', the initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

IFRS 9 is the initial stage of a project to replace IAS 39 'Financial Instruments: Recognition and Measurement' and will fundamentally change the way in which the Group accounts for financial instruments. Future stages are expected to result in amendments to IFRS 9 to deal with classification and measurement of financial liabilities, amortised cost and impairment and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements from the replacement of IAS 39.

Pronouncement	Nature of change	Effective date
IFRS 3 *Business Combinations*	The revised standard continues to apply the acquisition method to business combinations, however, all payments to purchase a business are to be recorded at fair value at the acquisition date, some contingent payments are subsequently remeasured at fair value through income, goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the minority interest, and all transaction costs are expensed.	Annual periods beginning on or after 1 July 2009.
IAS 27 *Consolidated and Separate Financial Statements*	Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is re-measured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.	Annual periods beginning on or after 1 July 2009.
IFRIC 17 *Distributions of Non-cash Assets to Owners*	Provides accounting guidance for non-reciprocal distributions of non-cash assets to owners (and those in which owners may elect to receive a cash alternative).	Annual periods beginning on or after 1 July 2009.
Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items*	Clarifies how the principles underlying hedge accounting should be applied in particular situations.	Annual periods beginning on or after 1 July 2009.
Improvements to IFRSs[1] (issued April 2009)	Sets out minor amendments to IFRS standards as part of annual improvements process.	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 January 2010.
Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions*	Clarifies that an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, whether or not settled in shares or cash.	Annual periods beginning on or after 1 January 2010.
Amendment to IAS 32 *Financial Instruments: Presentation – Classification of Rights Issues*[1]	Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated.	Annual periods beginning on or after 1 February 2010.
IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*[1]	Clarifies that when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor, a gain or loss is recognised in profit or loss representing the difference between the carrying value of the financial liability and the fair value of the equity instruments issued; the fair value of the financial liability is used to measure the gain or loss where the fair value of the equity instruments cannot be reliably measured.	Annual periods beginning on or after 1 July 2010.
IAS 24 *Related Party Disclosures*[1]	Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities	Annual periods beginning on or after 1 January 2011.
Amendment to IFRIC 14 *Prepayments of a Minimum Funding Requirement*[1]	Applies when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements and permits such an entity to treat the benefit of such an early payment as an asset	Annual periods beginning on or after 1 January 2011.
IFRS 9 *Financial Instruments: Classification and Measurement*[1]	Replaces those parts of IAS 39 'Financial Instruments: Recognition and Measurement' relating to the classification and measurement of financial assets. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity categories in existing IAS 39 will be eliminated.	Annual periods beginning on or after 1 January 2013.

[1] At the date of this report, these pronouncements are awaiting EU endorsement.

Notes to the accounts

55 Post balance sheet events

Following a reorganisation of Lloyds Banking Group on 1 January 2010, the Bank acquired 100 per cent of the issued ordinary share capital of HBOS plc from Lloyds Banking Group plc; the consideration for this transfer was the issue of 21.4 million shares to Lloyds Banking Group plc for a total value of £21,394 million.

56 Approval of the financial statements and other information

The financial statements were approved by the directors of Lloyds TSB Bank plc on 25 February 2010.

Lloyds TSB Bank plc and its subsidiaries form a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

RF64168