Lloyds Banking Group plc

Basel II Pillar 3 Disclosures
31 December 2010

CONTENTS

FOREWORD 4

SUMMARY ANALYSIS 5

INTRODUCTION 7

- Pillar 1 – Minimum Capital Requirements 7
- Pillar 2 – Supervisory Review Process 9
- Pillar 3 – Market Discipline 9

DISCLOSURE POLICY 10

SCOPE OF CONSOLIDATION 11

RISK MANAGEMENT OBJECTIVES AND POLICY 13

CAPITAL RESOURCES 19

- Lloyds Banking Group Capital Resources 22

CAPITAL REQUIREMENTS 23

- Lloyds Banking Group Risk Weighted Assets and Pillar 1 Capital Requirements 23
- Lloyds Banking Group Pillar 2 Capital Requirement 26

CREDIT RISK 27

- Credit Risk Exposure: Analysis by Exposure Class 32
- Credit Risk Exposure: Analysis by Division 34
- Credit Risk Exposure: Analysis by Industry 35
- Credit Risk Exposure: Analysis by Geography 37
- Credit Risk Exposure: Analysis by Residual Maturity 39
- Past Due Exposures, Impaired Exposures and Impairment Provisions 41
- Exposures Subject to the Internal Ratings Based Approach 50
- Exposures Subject to the Standardised Approach 68
- Non-Trading Book Exposures in Equities 73
- Securitisations 75

CREDIT RISK MITIGATION 85

COUNTERPARTY CREDIT RISK 90

MARKET RISK 93

OPERATIONAL RISK 98

APPENDIX 1: LLOYDS TSB BANK GROUP 101

APPENDIX 2: BOS GROUP 104

APPENDIX 3: LLOYDS BANKING GROUP CAPITAL RESOURCES (FORM 20-F) 107

APPENDIX 4: REMUNERATION DISCLOSURES 109

APPENDIX 5: GLOSSARY 115

CONTACTS 119

FORWARD LOOKING STATEMENTS

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

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

Factors that could cause actual business, strategy, plans and / or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's credit ratings; the ability to derive cost savings and other benefits as well as the ability to integrate successfully the acquisition of HBOS; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; technological changes; natural and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union (EU), the US or elsewhere; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Group as a result of HM Treasury's investment in the Group; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EU State Aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations; market related trends and developments; exposure to regulatory scrutiny, legal proceedings or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors; and the success of the Group in managing the risks of the foregoing.

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

FOREWORD

This document presents the consolidated Pillar 3 disclosures of Lloyds Banking Group plc ('the Group') as at 31 December 2010. The publication of this document fulfils a key requirement of the Basel II Framework, encouraging market discipline by allowing market participants to assess increased disclosure surrounding both the risk management framework and the capital adequacy of the Group.

The disclosures produced within this document have been prepared in accordance with minimum disclosure requirements established under the Capital Requirements Directive ('CRD'). These include new disclosure requirements for 2010, a result of the implementation of the 'CRD 2' package of amendments to the original Directive and the early implementation of the remuneration disclosure requirements forming part of the 'CRD 3' package of amendments. These disclosure requirements are interpreted within the UK through the Financial Service Authority's ('FSA') Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU').

In meeting these disclosure requirements the Group has considered the work undertaken by the former Committee of European Banking Supervisors ('CEBS') and both national and international trade associations in interpreting Pillar 3 disclosure requirements and in establishing best practice guidelines. As a result the Group has restructured its disclosures on securitisations, taking into account recommendations made through European best practice guidelines on Pillar 3 securitisation disclosures. Securitised balances relating to funding transactions where no significant risk transfer has occurred are outwith the scope of the guidelines and are no longer disclosed separately from the underlying exposure class. This principally applies to originated residential mortgage securitisations. Prior year comparatives have been restated on this basis where relevant.

As part of the move to align heritage credit risk capital calculation approaches the Group sought and received permission from the FSA to transfer heritage HBOS Advanced IRB portfolios to the Foundation IRB Approach in line with the heritage Lloyds TSB treatment. The Group has adopted the Foundation IRB Approach as the capital calculation approach for all material non-retail exposures in Wholesale and Wealth & International. The Group has adopted the heritage Lloyds TSB relationship model, risk appetite and many of its risk management models and methodologies and, as such, the Group believes that converging on the Foundation IRB Approach will facilitate integration work. All material retail portfolios across the Group remain on the Retail IRB Approach.

In addition to the changes surrounding the calculation of credit risk capital requirements and in support of the integration programme, the Group has moved to The Standardised Approach ('TSA') for determining operational risk capital requirements.

In satisfaction of significant subsidiary disclosure requirements, summary information pertaining to the consolidated capital resources and consolidated capital requirements of Lloyds TSB Bank plc ('Lloyds TSB Bank Group') and Bank of Scotland plc ('BOS Group') has been produced within the appendices to this document.

SUMMARY ANALYSIS

A high level summary analysis of the consolidated capital position and credit risk exposures of the Group as at 31 December 2010 is provided below.

CAPITAL RATIOS

	2010 Ratio %	2009 Ratio %
Core tier 1 capital ratio	**10.2%**	8.1%
Tier 1 capital ratio	**11.6%**	9.6%
Total capital ratio	**15.2%**	12.4%

Total capital resources as at 31 December 2010 amounted to £61.8bn (2009: £60.9bn), including tier 1 capital of £47.1bn (2009: £47.4bn). Core tier 1 capital amounted to £41.4bn (2009: £39.8bn).

RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENT

Total Risk Weighted Assets ('RWAs') as at 31 December 2010 amounted to £406.4bn (2009: £493.3bn), generating a Pillar 1 capital requirement of £32.5bn (£39.5bn). A summary breakdown of total RWAs by risk type is provided in the table below.

	2010 Risk Weighted Assets £m	2009 Risk Weighted Assets £m
Credit risk	**358,940**	452,104
Counterparty credit risk	**11,565**	12,245
Market risk	**4,217**	3,619
Operational risk	**31,650**	25,339
Total	**406,372**	493,307

Credit risk RWAs comprise £234.4bn (65%) of RWAs calculated under the Internal Ratings Based ('IRB') Approach (2009: £306.6bn, 68%) and £124.5bn (35%) of RWAs calculated under the Standardised Approach (2009: £145.5bn, 32%).

Key Movements

- Credit risk RWAs decreased by £93.2bn during the year, reflecting a combination of balance sheet reductions across all banking divisions, a revised assessment of Retail secured lending risk weighted assets following improvements in the economic outlook and changes introduced as a result of continuing the process of integrating the two heritage organisations' regulatory capital approaches which have impacted particularly on Wholesale. The changes referred to mainly concern the transfer of heritage HBOS Advanced IRB portfolios to the Foundation IRB Approach, following approval from the FSA. Further details on this can be found under the section entitled 'Scope of the IRB Permission' on p.50.

- Operational risk RWAs increased by £6.3bn following the Group's move to The Standardised Approach ('TSA'), further details of which can be found on p.99.

CREDIT RISK EXPOSURES

Total credit risk exposures (excluding counterparty credit risk exposures) as at 31 December 2010 amounted to £878.5bn (2009: £938.0bn) on an exposure at default ('EAD') basis.

This comprises £697.8bn (79%) of exposures risk weighted under the IRB Approach (2009: £742.7bn, 79%) and £180.7bn (21%) of exposures risk weighted under the Standardised Approach (2009: £195.3bn, 21%). A summary analysis of credit risk exposures is provided in the table below.

Exposure Category	2010 Credit Risk Exposure £m	2010 Risk Weighted Assets £m	2010 Average Risk Weight %
Corporates	156,878	108,830	69%
Central governments and central banks	22,920	1,290	6%
Institutions	23,927	4,371	18%
Retail	435,321	105,474	24%
Equities	2,331	5,529	237%
Securitisation positions	56,392	8,954	16%
Non credit obligation assets	-	-	-
Total – IRB Approach	697,769	234,448	34%
Central governments and central banks	40,168	60	0%
Institutions	825	292	35%
Corporates	44,386	40,965	92%
Retail	10,103	7,560	75%
Secured on real estate property	42,925	35,582	83%
Items belonging to regulatory high risk categories	170	236	139%
Securitisation positions	8	28	350%
Other [1]	42,148	39,769	94%
Total – Standardised Approach	180,733	124,492	69%
TOTAL	878,502	358,940	41%

Exposure Category	2009 Credit Risk Exposure £m	2009 Risk Weighted Assets £m	2009 Average Risk Weight %
Corporates	168,283	157,332	93%
Central governments and central banks	15,358	1,009	7%
Institutions	40,700	9,188	23%
Retail	445,679	124,503	28%
Equities	2,115	5,304	251%
Securitisation positions	68,882	7,828	11%
Non credit obligation assets	1,674	1,454	87%
Total – IRB Approach	742,691	306,618	41%
Central governments and central banks	35,353	83	0%
Institutions	668	242	36%
Corporates	55,980	52,734	94%
Retail	10,604	8,536	80%
Secured on real estate property	47,248	39,391	83%
Items belonging to regulatory high risk categories	1,197	4,069	340%
Securitisation positions	230	87	38%
Other [1]	43,985	40,344	92%
Total – Standardised Approach	195,265	145,486	75%
TOTAL	937,956	452,104	48%

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

INTRODUCTION

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

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

PILLAR 1 – MINIMUM CAPITAL REQUIREMENTS

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

Risk	Complexity Least	----------▶	Most
Wholesale Credit	Standardised Approach	Foundation Internal Ratings Based Approach (FIRB)	Advanced Internal Ratings Based Approach (AIRB)
Retail Credit	Standardised Approach	-	Retail Internal Ratings Based Approach (RIRB)
Counterparty Credit	Standardised Approach	Foundation Internal Ratings Based Approach (FIRB)	Advanced Internal Ratings Based Approach (AIRB)
Market	Standardised Approach	-	Internal Models Approach (IMA)
Operational	Basic Indicator Approach (BIA)	Standardised Approach (TSA)	Advanced Measurement Approach (AMA)

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

Credit Risk

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

The IRB Approach represents a significantly more advanced method of calculating credit risk capital requirements. It is further sub-divided into two distinct approaches for wholesale exposures – the Foundation IRB Approach and the Advanced IRB Approach. For retail exposures, a single approach referred to as the Retail IRB Approach is available and is equivalent in complexity to the Advanced IRB Approach. Application of any IRB approach requires approval from the FSA.

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

Under each of the IRB approaches referred to above, the three risk components (PD, LGD and EAD) form the base inputs to the formulae used to derive the credit risk capital requirement applying to the exposure. This reflects the capital required to cover any unexpected loss in relation to the exposure.

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

EL = (PD% * LGD% * EAD)

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

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

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

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

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

The Advanced IRB Approach had previously been used in relation to heritage HBOS wholesale IRB portfolios. The transition of these portfolios to the Foundation IRB Approach took place at the end of 2010, following approval from the FSA. Application of the Advanced IRB Approach to all such portfolios remains a long term objective of the Group.

The Group currently makes use of the Supervisory Slotting Approach and the Simple Risk Weight Method for certain corporate specialised lending portfolios and equity exposures respectively. As a result of finalisation of the Group's integrated IRB waiver permission all equity exposures are expected to transition to the Standardised Approach during 2011.

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

Counterparty Credit Risk

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

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

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

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

Market Risk

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

Lloyds Banking Group is permitted by the FSA to calculate market risk capital requirements for the trading book using its VaR models. Market risk positions not covered by the VaR model permission, if deemed material, are captured through an additional incremental capital charge.

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

Operational Risk

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

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

- The Standardised Approach ('TSA') determines a capital requirement based on the three year average of the aggregate risk weighted relevant indicators of the underlying business. This requires a firm's activities to be split into a number of defined business lines with a specific risk weight applied to the relevant indicator of each business line. An Alternative Standardised Approach is also available which uses alternative indicators in relation to the defined business lines. Firms must meet certain qualifying criteria to be able to use the Standardised or Alternative Standardised Approach.

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

Within Lloyds Banking Group, operational risk capital requirements are determined under The Standardised Approach.

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

PILLAR 2 – SUPERVISORY REVIEW PROCESS

The second pillar of the Basel II Framework is designed to assess the adequacy of a firm's capital resources by considering all material risks to the business, including those not covered or adequately addressed by the first pillar, and the impact upon the capital position that is forecast to occur using stressed macroeconomic scenarios. Furthermore, requirements under Pillar 2 encourage firms to develop, operate and evolve better risk management techniques for monitoring, measuring and managing material risks.

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

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

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

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

PILLAR 3 – MARKET DISCIPLINE

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

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

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

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

DISCLOSURE POLICY

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

BASIS OF PREPARATION

This document contains the consolidated Pillar 3 disclosures of Lloyds Banking Group plc as at 31 December 2010, prepared in accordance with the requirements of BIPRU Chapter 11 (Disclosure – Pillar 3).

In satisfaction of certain disclosure requirements, reference has been made to the 2010 Lloyds Banking Group plc Annual Report and Accounts. As such, this document should be read in conjunction with the Annual Report and Accounts. It is however important to note that a number of significant differences exist between accounting disclosures published under International Financial Reporting Standards ('IFRS') and Pillar 3 disclosures published under Basel II which prevent direct comparison in a number of areas. Of particular note are the differences surrounding scope of consolidation and the definition of credit risk exposure.

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

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

FREQUENCY, MEDIA AND LOCATION

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

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

VERIFICATION

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

SCOPE OF CONSOLIDATION

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

INTRODUCTION

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

REGULATORY CONSOLIDATION

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

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

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

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

Insurance undertakings are themselves required to maintain capital adequacy under the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Insurers ('INSPRU'). As at 31 December 2010 there were no such undertakings where actual capital resources were less than the regulatory minimum required.

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

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

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

SUB GROUP DISCLOSURES

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

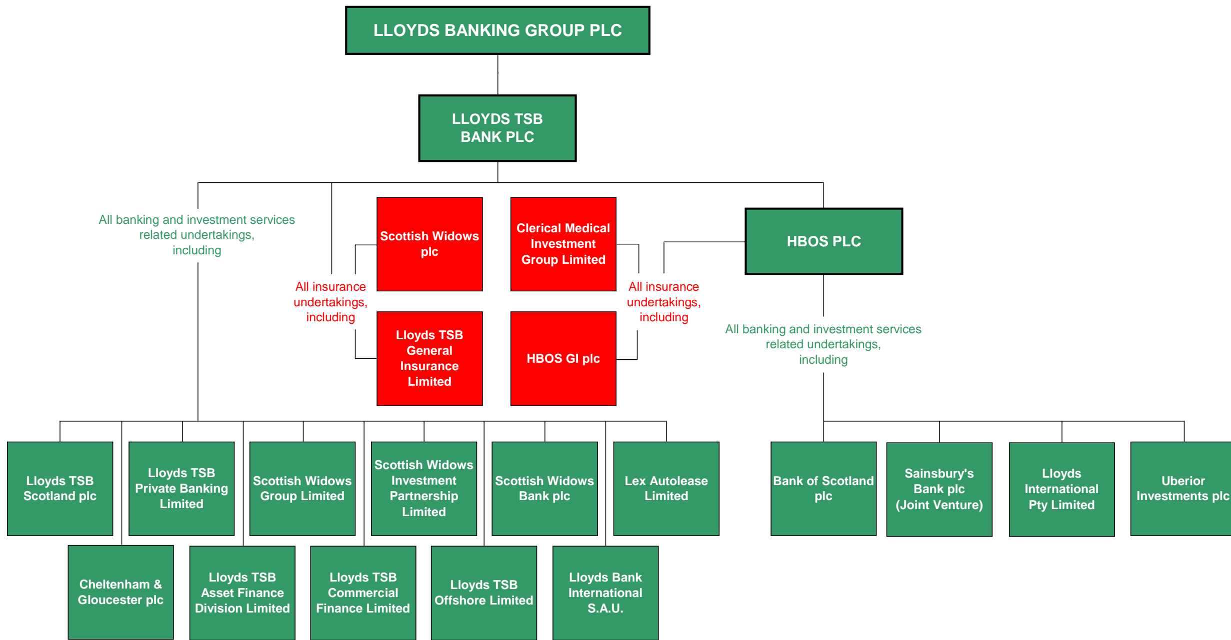
SOLO CONSOLIDATION

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

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

REGULATORY CONSOLIDATION GROUP

A summarised diagrammatical representation (as at 31 December 2010) of the regulatory consolidation group upon which the disclosures presented within this document are based is provided below.



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

RISK MANAGEMENT OBJECTIVES AND POLICY

THE GROUP'S APPROACH TO RISK

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

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

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assessing the impact of emerging risks from legislation, new technologies or the market, and developing risk tolerances and mitigating strategies. The framework seeks to: strengthen the Group's ability to identify and assess risks, aggregate group-wide risks and define the corporate risk appetite, develop solutions for reducing or transferring risk, and where appropriate, exploit risks to gain competitive advantage, thereby seeking to increase shareholder value.

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

The Group Business Risk Committee and the Group Asset and Liability Committee are chaired by the Group Chief Executive and include all members of the Group Executive Committee. The aggregate group wide risk profile and portfolio appetite are discussed at these monthly meetings. The Risk Committee, chaired by a Non-Executive Director, comprises other Non-Executive Directors and oversees the Group's risk exposures. This Second-Line-Of-Defence Committee is supported by the Chief Risk Officer, who is independent of the front line business units, is a full member of the Group Executive Committee and reports to the Group Chief Executive. The Chief Risk Officer regularly informs the Risk Committee of the aggregate risk profile and has direct access to the Chairman and members of the Risk Committee.

RISK AS A STRATEGIC DIFFERENTIATOR

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

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

As part of its integration initiative, the Group has rolled out the methodology and financial control framework that was used by the heritage Lloyds TSB Group; including compliance with the requirements of the US Sarbanes Oxley Act.

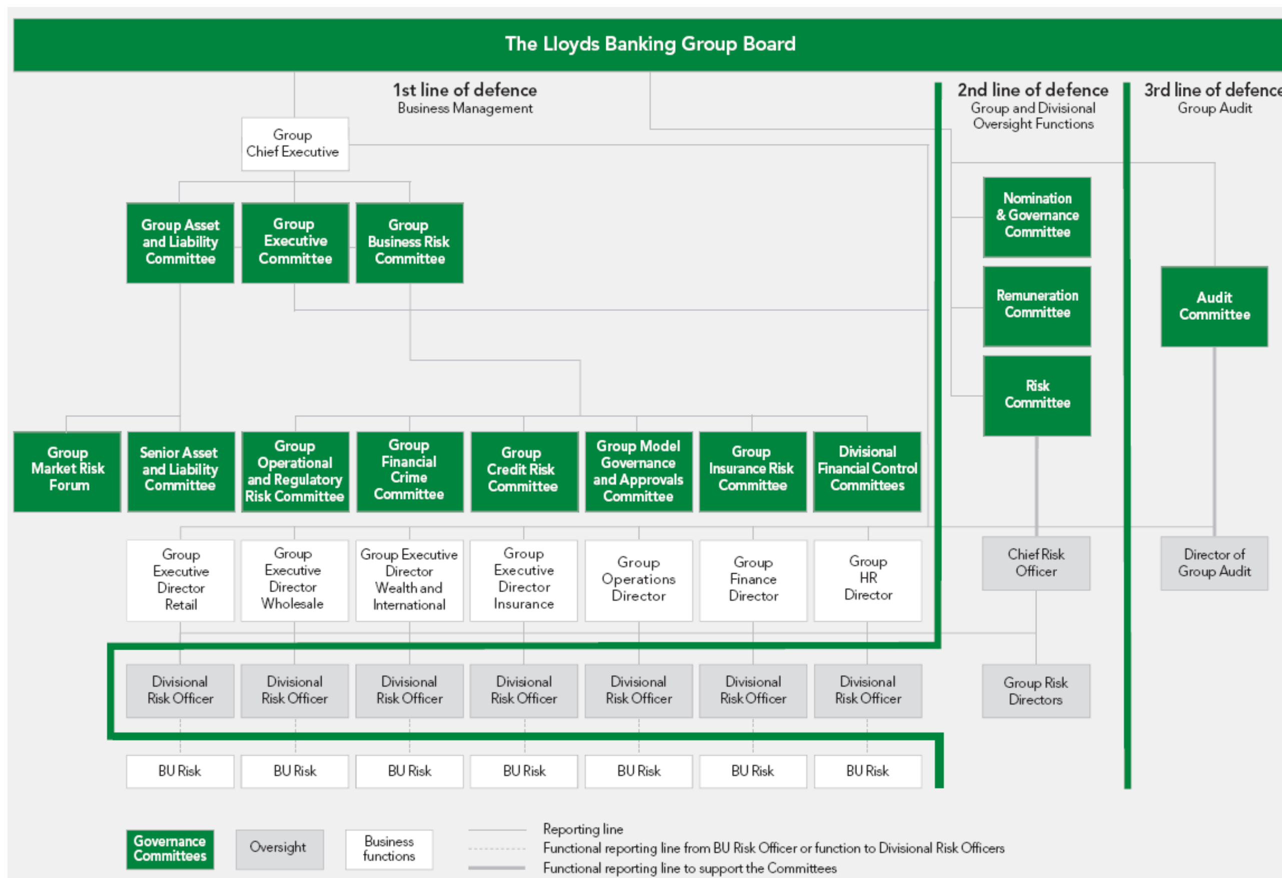
Risk analysis and reporting capabilities support the identification of opportunities as well as risks and it provides an aggregate view of the overall risk portfolio. Risk mitigation strategies clearly aligned with responsibilities and timescales are monitored at group and divisional level.

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

RISK GOVERNANCE

The embedding of an integrated governance and risk management framework throughout the Group has continued, through a consistent approach to risk appetite, policies, delegations and Risk Committee structures.

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



BOARD AND COMMITTEES

The Board, assisted by its key Risk Committees (Risk Committee and Audit Committee), approves the Group's overall risk management framework. The Board also reviews the Group's aggregate risk exposures and concentrations of risk to ensure that these are consistent with the Board's appetite for risk. The role of the Risk Committee, Audit Committee and other key risk oversight roles are described below.

The **Risk Committee**, (formerly Risk Oversight Committee) which comprises non-executive directors, oversees the development, implementation and maintenance of the Group's overall risk management framework and its risk appetite, strategy, principles and policies, to ensure that these are in line with emerging regulatory, corporate governance and industry best practice. The Risk Committee regularly reviews the Group's risk exposures across the primary risk drivers and the detailed risk types. In addition the Risk Committee facilitates the involvement of non-executive directors in risk issues and aids their understanding of these issues, oversees adherence to Group risk policies and standards and considers any material amendments to them and reviews the work of the Group risk division.

The **Audit Committee** which comprises non-executive directors, monitors and reviews the formal arrangements established by the Board in respect of the financial statements and reporting of the Group, internal controls and the risk management framework, internal audit, and the Group's relationship with its external auditors. In carrying out these duties, the committee undertakes the following tasks:

– reviews the financial statements published in the name of the Board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures;

– reviews the scope of the work of the group audit department, reports from that department and the adequacy of its resources;

– reviews the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations;

– approves the external auditors' terms of engagement and remuneration;

– assesses the external auditors' independence and objectivity;

– recommends the external auditors' appointment, re-appointment and removal;

– reviews the results of the external audit and its cost effectiveness;

– reviews reports from the auditors on audit planning and their findings on accounting and internal control systems; and

– reviews procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence.

The **Group Executive Committee** assisted by the Group Business Risk Committee and the Group Asset and Liability Committee, supports the Group Chief Executive in ensuring the effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, whilst also reviewing the Group's aggregate risk exposures and concentrations of risk.

The **Group Asset and Liability Committee** is responsible for the strategic management of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility. The Group Asset and Liability Committee is supported by the **Senior Asset and Liability Committee**. This Senior Level Committee is responsible for the review of documentation relating to the management of assets and liabilities in the Group's balance sheet and the escalation of issues of group-level significance to the Group Asset and Liability Committee. It is also supported by the **Group Market Risk Forum** which escalates matters relating to the strategic management of the Group's structural market risks, including market risks held in the Group's insurance companies.

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

The Group Business Risk Committee is supported by the following Committees:

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

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

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

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

– The **Group Financial Crime Committee** serves as the principal Group forum for reviewing and challenging the management of financial crime risk including the overall strategy and performance. The Committee is accountable for ensuring that, at Group level, financial crime risks are effectively identified and managed within risk appetite and that strategies for financial crime prevention are effectively co-ordinated and implemented across the Group.

– The **Divisional Financial Control Committees**, which provide governance over financial statements. The meetings provide review and challenge as to the veracity of the results, press releases and supporting analyst information with oversight over the processes that have been followed in drawing them up. Items of focus are key assumptions and areas of subjectivity in the results and ensuring proper remediation of control issues that impact internal controls over financial reporting. The Group's auditors also report findings from their audit work.

The Group Risk Directors and Divisional Risk Officers meet on a regular basis under the Chairmanship of the Chief Risk Officer to review and challenge the risk profile of the Group and to ensure that mitigating actions are appropriate. Aggregate risk reports are reviewed by this group before submission to Group Business Risk Committees and then to Risk Committee.

Group Executive Directors have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group's high level policies and within the parameters set by the Board, Group Executive Committee and Group Risk. Compliance with policies and parameters is overseen by the Risk Committee, the Group Business Risk Committee, the Group Asset and Liability Committee, Group Risk and the Divisional Risk Officers.

RISK MANAGEMENT OVERSIGHT

The Chief Risk Officer oversees and promotes the development and implementation of a consistent Group-wide risk management framework. The Chief Risk Officer, supported by the Group Risk Directors and the Divisional Risk Officers, provides objective challenge to the Group's senior management. The Group Executive Committee and the Board receive regular briefings and guidance from the Chief Risk Officer to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

Group Risk Directors who report directly to the Chief Risk Officer, are allocated responsibility for specific risk types and are responsible for ensuring the adequacy of the framework for their risk types as well as the oversight of the risk profile across the Group. Divisional Risk Officers have dual reporting lines to their own divisional executive and also to the Chief Risk Officer and are responsible for the risk profile within their own divisions. This matrix approach enables the Group Executive Committee members to fulfil their risk management accountabilities.

Divisional Risk Officers provide oversight of risk management activity for all risks within each of the Group's divisions. Reporting directly to the Group Executive Directors responsible for the divisions and to the Chief Risk Officer, their day-to-day contact with business management, business operations and risk initiatives provides an effective risk oversight mechanism.

The Director of Group Audit provides independent assurance to the Audit Committee and the Board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group Audit is fully independent of Group Risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

RISK MANAGEMENT IN THE BUSINESS

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

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

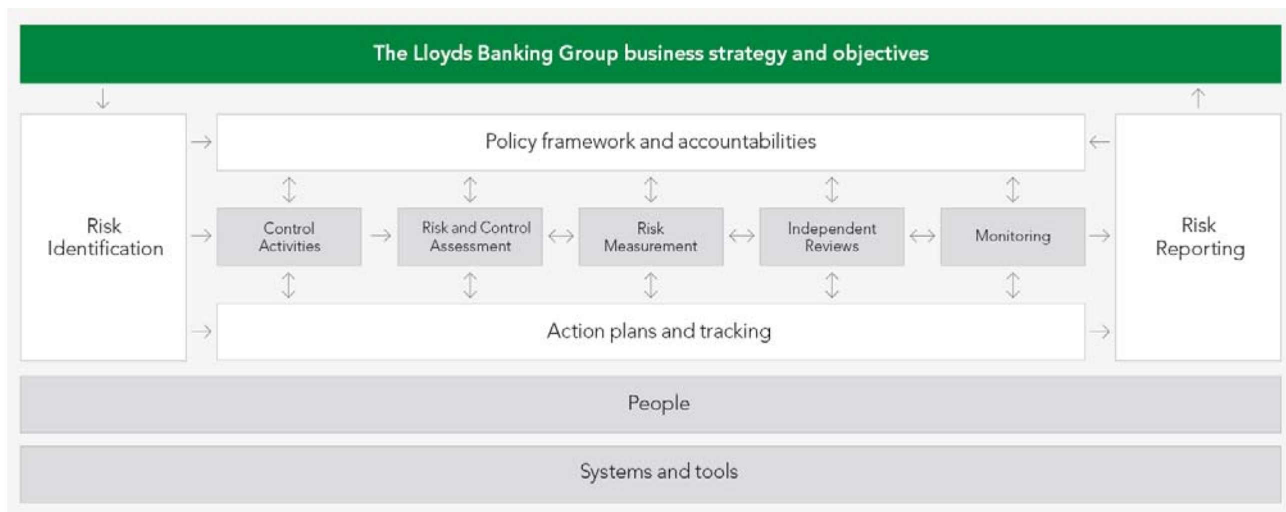
Risk management in the business forms part of a tiered risk management model, as shown on p.14, with the Divisional Risk Officers and Group Risk providing oversight and challenge, as described above, and the Chief Risk Officer and group committees establishing the group-wide perspective.

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

RISK MANAGEMENT FRAMEWORK

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

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assessing the impact of emerging risks from legislation, new technologies or the market, and developing risk tolerances and mitigating strategies. The framework seeks to: strengthen the Group's ability to identify and assess risks, aggregate group-wide risks and define the group risk appetite, develop solutions for reducing or transferring risk, and where appropriate, exploit risks to gain competitive advantage, thereby seeking to increase shareholder value. The principal elements of the risk management framework are shown in the table on p.17. The framework comprises 11 interdependent activities which map to the components of the internal control integrated framework issued by the Committee of Sponsoring Organisations of the Treadway Commission.



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

The **Lloyds Banking Group business strategy and objectives** are used to determine the Group's high level risk principles and risk appetite measures and metrics for the primary risk drivers (see table on p.18). The risk appetite is proposed by the Group Chief Executive and reviewed by various governance bodies including the Group Executive Committee and the Risk Committee. Responsibility for the approval of risk appetite rests with the Board. The approved high level appetite and limits are delegated to individual Group Executive Committee members by the Group Chief Executive.

The more detailed description of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses are determined by the Group Chief Executive, in consultation with the Group Business Risk Committee and the Group Asset and Liability Committee.

The risk principles are executed through the **Policy Framework and Accountabilities**. These principles are supported by the policy levels below:

Principles – high level principles for the six primary risk drivers

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

Detailed group policy – detailed policy that applies across the Group

Divisional policy – local policy that specifically applies to a division

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

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy and the associated accountabilities are clearly outlined to all colleagues.

Colleagues are expected to be aware of policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all colleagues within that area.

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

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

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

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

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

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

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

At group level, a consolidated risk report is produced which is reviewed and debated by the Group Business Risk Committee, Group Executive Committee, Risk Committee and the Board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The consolidated risk report provides a quarterly assessment of the aggregate residual risk for the primary risk drivers, comparing the assessment with the previous quarter and providing a forecast for the next six months.

RISK DRIVERS

The Group's risk language is designed to capture the Group's 'primary risk drivers'. A description of each 'primary risk driver', including definition, appetite, control and exposures, is included below. These are further sub divided into 31 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out in the table below.

Primary risk drivers	Business Risk	Credit Risk	Market Risk	Insurance Risk	Operational Risk	Financial Soundness
Detailed risk types	Execution of strategy	Retail Wholesale Wealth and International	Interest rate Foreign exchange Equity Credit spread	Mortality Longevity Morbidity Persistency Property Expenses Unemployment	Legal and regulatory Customer treatment People Supplier management Customer processes Financial crime Money laundering and sanctions Security IT systems Change Organisational infrastructure	Capital Liquidity and funding Financial and prudential regulatory reporting Disclosure Tax

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

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

Further details on the Group's risk management processes in relation to business risk, insurance risk, liquidity and funding, financial and prudential regulatory reporting, disclosure and tax can be found in the Risk Management section of the 2010 Lloyds Banking Group plc Annual Report and Accounts (pages 65 to 108).

CAPITAL RESOURCES

CAPITAL RISK

Definition

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

Risk Appetite

Capital risk appetite is set by the Board and reported through various metrics that enable the Group to manage capital constraints and market expectations. The Group Chief Executive, assisted by the Group Asset and Liability Committee, regularly reviews performance against risk appetite. A key metric is the Group's core tier 1 capital ratio. The Group's target for this and other aspects of appetite will be reviewed in 2011 in the light of further clarity of regulatory and accounting reforms.

Exposure

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

Measurement

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

A number of limits are imposed by the FSA on the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities, for example the amount of qualifying tier 2 capital cannot exceed that of tier 1 capital.

The FSA requires the Group to hold sufficient regulatory capital to cover its total capital requirements under Pillar 1 and Pillar 2. In addition to this, the FSA has made statements to explain it also operates a framework of targets and expected buffers for core tier 1 and tier 1.

The Group seeks to ensure that the regulatory minimum requirements are met at all times and undertakes an extensive series of stress analyses during the year to determine the adequacy of the Group's capital resources against the FSA minimum requirements in severe economic conditions.

During 2010 the Basel Committee on Banking Supervision has substantially refined the details of the so called 'Basel III' reforms for an enhanced global capital accord. These include increased minimum levels of and quality standards for capital, increased risk weighting of assets, and the introduction of a minimum leverage ratio, as well as the timing and transitional arrangements for implementation. The final details are still to be clarified, particularly as the reforms are implemented within the European and UK regulations, which may include a countercyclical buffer, requiring higher levels of capital to be held at certain points of the economic cycle, and higher capital requirements for systemically important financial institutions.

The effect of the Basel III reforms is uncertain as much will depend on business performance and mitigating actions that can be completed, even before the transition period comes in to effect. However lower risk weighted assets are expected from the planned reduction in the non-core balance sheet. Analysis suggests that with no mitigating actions the reforms will reduce the Group's core tier 1 ratio by approximately 1.2 per cent in 2013. The additional impact in 2014 of deducting the equity investment in insurance in excess of 10 per cent, transitioning in at 20 per cent per annum from 1 January 2014, would be around 0.3 per cent were the Group to take no further action to mitigate this. The Group is confident that it is well positioned to maintain a strong capital position, meeting all regulatory requirements as currently formulated.

Mitigation

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

The Group is able to accumulate additional capital through profit retention, by raising equity via, for example, a rights issue or debt exchange and by raising tier 1 and tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time.

The Group has in issue as part of tier 2 capital resources, enhanced capital notes which will convert to core tier 1 capital in the event that Group's published core tier 1 ratio (as defined by the FSA in May 2009) falls below 5 per cent.

Additional measures which have been used to manage the Group's capital position include seeking to strike an appropriate balance of capital held within its insurance and banking subsidiaries and through improving the quality of its capital through liability management exercises. Regulatory requirements are primarily controlled through the quality and volume of lending but are also affected through the modelling approaches used to determine risk weighted assets and expected losses.

Monitoring

Capital is actively managed and regulatory ratios are a key factor in the Group's budgeting and planning processes. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios, including those that would occur under stressed scenarios, is made to the Senior Asset and Liability Committee, the Group Asset and Liability Committee and the Board.

MOVEMENTS IN CAPITAL

Tier 1 Capital

Core tier 1 capital increased by £1,567m over the year largely reflecting the issue of ordinary shares in exchange for certain preference shares, preferred securities and undated subordinated debt issued by the Group. This has been partially offset by a deduction in respect of post-retirement benefits reflecting the impact of the curtailment gain, which is not allowed for capital purposes and a commitment to make increased deficit contributions to the HBOS final salary pension scheme following the completion of an actuarial valuation.

Tier 1 capital has decreased by £252m over the year. The increase in core tier 1 capital was more than offset by the redemption of the preference shares and preferred securities as part of the liability management exercises referred to above.

The movements in core tier 1 and tier 1 capital in the year are shown below.

	Core Tier 1 £m	Tier 1 £m
At 31 December 2009	39,804	47,399
Loss attributable to ordinary shareholders	(320)	(320)
Issue of ordinary shares	2,237	2,237
Increase in regulatory post-retirement benefit adjustments	(1,486)	(1,486)
Redemption of preference shares and preferred securities	-	(1,869)
Decrease in goodwill, intangible assets and other deductions	786	717
Other movements	350	469
At 31 December 2010	**41,371**	**47,147**

Tier 2 Capital

Tier 2 capital has increased principally as a result of new issues of tier 2 debt and favourable foreign exchange rate movements partially offset by the redemption of undated subordinated debt described above, amortisation for regulatory purposes of dated subordinated debt and lower eligible provisions.

Supervisory Deductions

Supervisory deductions mainly consist of investments in subsidiary undertakings that are not within the banking group for regulatory purposes. These investments are primarily the Scottish Widows and Clerical Medical life and pensions businesses, together with the general insurance business. Supervisory deductions relating to these businesses have benefitted from repatriation of capital during the year. Also included within deductions for other unconsolidated investments at 31 December 2010 are investments in non-financial entities that are held by our private equity (including venture capital) businesses. These investments were previously risk weighted in accordance with industry wide guidance provided by the FSA. This guidance has now expired.

CAPITAL SECURITIES

Summary information on the terms and conditions attached to capital securities (subordinated liabilities and share capital) issued by the Group is presented on pages 216 to 224 of the 2010 Lloyds Banking Group plc Annual Report and Accounts.

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

Following the implementation of the 'CRD 2' package of amendments to the Capital Requirements Directive, new requirements surrounding hybrid capital securities have been included in GENPRU. The principal changes arising out of these new requirements are that qualifying hybrid capital securities must display a greater degree of permanence and loss absorbency, have flexibility surrounding coupon or dividend payments and include the ability to write down or to convert into ordinary shares upon a trigger event. Where the requirements are satisfied, hybrid capital securities may be included within a firm's non-core tier 1 capital.

Existing non-core tier 1 securities that do not meet the new requirements surrounding hybrid capital securities can be recognised as such under the grandfathering provisions attached to the CRD 2 amendments. These provisions allow for the continued recognition of such securities within tier 1 capital over the next 30 years, subject to a reducing limit and adherence to the requirements of the provisions. GENPRU transitional provision TP 8A establishes these requirements within the UK. Future amendments to the Capital Requirements Directive as a result of the implementation of Basel III reforms are likely to result in further changes to the recognition and treatment of hybrid capital securities and related grandfathering provisions.

Under the CRD 2 grandfathering provisions, the Group has recognised its preference share capital and preferred securities as hybrid capital securities. Pages 217 and 218 of the 2010 Lloyds Banking Group plc Annual Report and Accounts provide details on the Group's preference share capital and preferred securities. These are included within the Group's non-core tier 1, subject to the regulatory adjustments required. Note that under the provisions of GENPRU TP 8.5, the 6.90% Perpetual Capital Securities (US$1,000 million) classed under preferred securities within the Annual Report and Accounts are recognised as perpetual non-cumulative preference shares for regulatory capital purposes.

Details of the Group's tier 2 capital securities are provided on pages 219 to 221 of the 2010 Lloyds Banking Group plc Annual Report and Accounts. A list of those tier 2 capital securities disclosed that included an incentive at issuance for the firm to redeem them is provided below. Note that this excludes securities issued by insurance subsidiaries.

Undated subordinated liabilities with an incentive for the firm to redeem them included at issuance [1]	Dated subordinated liabilities with an incentive for the firm to redeem them included at issuance [1]
• 6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	• Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)
• 5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	• Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)
• 6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	• Callable Floating Rate Subordinated Notes 2016 (€500 million)
• 8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	• Subordinated Notes 2016 (€500 million)
• 6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	• Notes 2016 (US$750 million)
• 6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	• Subordinated Lower Tier II Notes 2017 (€1,000 million)
• 5.625% Cumulative Callable Fixed to Floating Rate Undated Sub Notes (£500 million)	• Subordinated Callable Notes 2017 (US$1,000 million)
• 4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)	• Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)
• Floating Rate Undated Subordinated Notes (€500 million)	• 6.75% Subordinated Callable Fixed/Floating Rate Instruments 2017 (Aus$200 million)
• 5.375% Undated Fixed to Floating Rate Subordinated Notes (US$1,000 million)	• 5.109% Callable Fixed to Floating Rate Notes 2017 (Can$500 million)
• 5.125% Undated Subordinated Fixed to Floating Notes (€750 million)	• 6.305% Lower Tier II Subordinated Notes 2017 (£500 million)
• 5.75% Undated Subordinated Step-up Notes (£600 million)	• 5.625% Sub Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)
• 6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	• 4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)
• 7.5% Undated Subordinated Step-up Notes (£300 million)	• 6.9625% Sub Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)
• 8.625% Perpetual Subordinated Notes (£200 million)	• 5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)
• Floating Rate Undated Subordinated Step-up Notes (€300 million)	• 4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)
• 10.25% Subordinated Undated Instruments (£100 million)	
• 5.75% Undated Subordinated Step-up Notes (£500 million)	
• 7.375% Subordinated Undated Instruments (£150 million)	

[1] The notes provided on p.219 and p.221 of the 2010 Lloyds Banking Group plc Annual Report and Accounts provide further details on the terms and conditions attached to these securities, including conditions imposed under the state aid restructuring plan, where relevant.

LLOYDS BANKING GROUP CAPITAL RESOURCES

The capital resources of the Group as at 31 December 2010 are presented in the table below.

		2010		2009 [3]
	£m	£m	£m	£m
Core tier 1				
Ordinary share capital and reserves		46,879		44,275
Regulatory post-retirement benefit adjustments		(1,052)		434
Available-for-sale revaluation reserve		285		783
Cash flow hedging reserve		391		305
Other items		306		231
		46,809		46,028
Less deductions from core tier 1				
Goodwill and other intangible assets		(5,224)		(5,779)
Other deductions		(214)		(445)
Core tier 1 capital		41,371		39,804
Perpetual non-cumulative preference shares				
Preference share capital [1]		1,507		2,639
Innovative tier 1 capital instruments				
Preferred securities [1]		4,338		4,956
Less deductions from tier 1				
Other deductions		(69)		-
Total tier 1 capital		47,147		47,399
Total tier 1 capital (excluding innovative tier 1) [2]	*42,809*		*42,443*	
Tier 2				
Available-for-sale revaluation reserve in respect of equities		462		221
Undated subordinated debt		1,968		2,575
Eligible provisions		2,468		2,694
Dated subordinated debt		23,167		20,068
Less deductions from tier 2				
Other deductions		(283)		(445)
Total tier 2 capital		27,782		25,113
Total tier 2 capital (including innovative tier 1) [2]	*32,120*		*30,069*	
Supervisory deductions				
Unconsolidated investments – life		(10,042)		(10,015)
Unconsolidated investments – general insurance and other		(3,070)		(1,551)
Total supervisory deductions		(13,112)		(11,566)
Total Capital Resources		61,817		60,946
Risk Weighted Assets		406,372		493,307
Core tier 1 ratio (%)		10.2%		8.1%
Tier 1 capital ratio (%)		11.6%		9.6%
Total capital ratio (%)		15.2%		12.4%

[1] Preference share capital and preferred securities represent the Group's hybrid capital instruments. These are included within tier 1 capital in accordance with the grandfathering provisions issued by the FSA (GENPRU TP 8A).

[2] The disclosure of tier 1 capital excluding innovative tier 1 instruments and tier 2 capital including innovative tier 1 instruments has been produced to meet the disclosure requirements of BIPRU Chapter 11. The traditional presentation of innovative tier 1 instruments within tier 1 capital has been maintained in the second and fourth columns as this reflects the disclosure adopted within the 2010 Lloyds Banking Group plc Annual Report and Accounts and the prescribed treatment under GENPRU. Both the application of regulatory restrictions (capital resources gearing rules) and the calculation of capital ratios assume the traditional treatment of innovative tier 1 instruments.

[3] Restated to reflect a prior year adjustment to available-for-sale revaluation reserves.

CAPITAL REQUIREMENTS

LLOYDS BANKING GROUP RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of the Group as at 31 December 2010 are presented in the table below. Notes in relation to the references below can be found on p.25.

(All figures are in £m)	2010 Risk Weighted Assets	2010 Pillar 1 Capital Requirements	2009 Risk Weighted Assets	2009 Pillar 1 Capital Requirements
CREDIT RISK				
Exposures subject to the IRB Approach				
Advanced IRB Approach				
Corporate - Main	-	-	65,914	5,273
Corporate - SME	-	-	19,021	1,522
Central governments and central banks	-	-	132	11
Institutions	-	-	7,009	561
Foundation IRB Approach				
Corporate - Main	74,720	5,978	47,437	3,795
Corporate - SME	20,285	1,623	6,114	489
Corporate - Specialised lending	7,428	594	11,014	881
Central governments and central banks	1,290	103	877	70
Institutions	4,371	350	2,179	174
Retail IRB Approach				
Retail - Residential mortgages	60,950	4,876	77,362	6,188
Retail - Qualifying revolving retail exposures	24,765	1,981	23,854	1,908
Retail - Other retail	17,690	1,415	20,765	1,661
Retail - SME	2,069	166	2,522	202
Other IRB Approaches [1]				
Corporate - Specialised lending	6,397	512	7,832	627
Equities - Exchange traded	179	14	432	35
Equities - Private equity	3,217	257	2,534	203
Equities - Other	2,133	171	2,338	187
Securitisation positions [2]	8,954	716	7,828	626
Non credit obligation assets [3]	-	-	1,454	116
Total - IRB Approach	234,448	18,756	306,618	24,529
Exposures subject to the Standardised Approach				
Central governments and central banks	60	5	83	7
Regional governments or local authorities	14	1	25	2
Administrative bodies and non-commercial undertakings	294	24	323	26
Institutions	292	23	242	19
Corporates	40,965	3,277	52,734	4,219
Retail	7,560	604	8,536	683
Secured on real estate property	35,582	2,847	39,391	3,152
Past due items	15,286	1,223	14,186	1,135
Items belonging to regulatory high risk categories	236	19	4,069	325
Securitisation positions	28	2	87	7
Short term claims on institutions or corporates	824	66	632	50
Other items [3], [4]	23,351	1,868	25,178	2,014
Total - Standardised Approach	124,492	9,959	145,486	11,639
Total Credit Risk	358,940	28,715	452,104	36,168
COUNTERPARTY CREDIT RISK				
IRB Approach	5,207	417	5,692	456
Standardised Approach	6,358	508	6,553	524
Total Counterparty Credit Risk	11,565	925	12,245	980
MARKET RISK				
Internal Models Approach	2,494	200	2,104	168
Standardised Approach				
Interest rate position risk requirement	1,657	133	1,378	110
Foreign currency position risk requirement	61	5	128	10
Commodity position risk requirement	5	-	9	1
Total Market Risk	4,217	338	3,619	289
OPERATIONAL RISK				
Advanced Measurement Approach	-	-	24,777	1,982
Standardised Approach	31,650	2,532	562	45
Total Operational Risk	31,650	2,532	25,339	2,027
TOTAL	406,372	32,510	493,307	39,464

DIVISIONAL RISK WEIGHTED ASSETS

The risk weighted assets of the Divisions as at 31 December 2010 are presented in the table below. Notes in relation to the references below can be found on p.25.

(All figures are in £m) 2010	Retail	Wholesale	Wealth & International	Group Ops & Central Items	TOTAL
CREDIT RISK					
Exposures subject to the IRB Approach					
Advanced IRB Approach					
Corporate - Main	-	-	-	-	-
Corporate - SME	-	-	-	-	-
Central governments and central banks	-	-	-	-	-
Institutions	-	-	-	-	-
Foundation IRB Approach					
Corporate - Main	-	71,800	2,682	238	74,720
Corporate - SME	-	20,246	39	-	20,285
Corporate - Specialised lending	-	7,395	33	-	7,428
Central governments and central banks	-	521	50	719	1,290
Institutions	-	4,351	20	-	4,371
Retail IRB Approach					
Retail - Residential mortgages	49,732	3,841	7,325	52	60,950
Retail - Qualifying revolving retail exposures	24,765	-	-	-	24,765
Retail - Other retail	13,077	4,543	70	-	17,690
Retail - SME	-	2,069	-	-	2,069
Other IRB Approaches [1]					
Corporate - Specialised lending	-	5,847	550	-	6,397
Equities - Exchange traded	-	179	-	-	179
Equities - Private equity	-	3,217	-	-	3,217
Equities - Other	-	2,133	-	-	2,133
Securitisation positions [2]	-	8,954	-	-	8,954
Non credit obligation assets [3]	-	-	-	-	-
Total - IRB Approach	87,574	135,096	10,769	1,009	234,448
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	60	-	60
Regional governments or local authorities	-	9	5	-	14
Administrative bodies and non-commercial undertakings	-	280	14	-	294
Institutions	-	74	116	102	292
Corporates	133	25,643	13,707	1,482	40,965
Retail	1,099	1,751	4,710	-	7,560
Secured on real estate property	2,105	20,825	12,652	-	35,582
Past due items	1,484	3,876	9,926	-	15,286
Items belonging to regulatory high risk categories	-	170	66	-	236
Securitisation positions	-	-	28	-	28
Short term claims on institutions or corporates	-	807	17	-	824
Other items [3], [4]	885	7,904	1,467	13,095	23,351
Total - Standardised Approach	5,706	61,339	42,768	14,679	124,492
Total Credit Risk	93,280	196,435	53,537	15,688	358,940
COUNTERPARTY CREDIT RISK					
IRB Approach	-	5,207	-	-	5,207
Standardised Approach	-	6,355	3	-	6,358
Total Counterparty Credit Risk	-	11,562	3	-	11,565
MARKET RISK					
Internal Models Approach	-	2,494	-	-	2,494
Standardised Approach					
Interest rate position risk requirement	-	1,657	-	-	1,657
Foreign currency position risk requirement	-	61	-	-	61
Commodity position risk requirement	-	5	-	-	5
Total Market Risk	-	4,217	-	-	4,217
OPERATIONAL RISK					
Advanced Measurement Approach	-	-	-	-	-
Standardised Approach	15,974	10,502	5,174	-	31,650
Total Operational Risk	15,974	10,502	5,174	-	31,650
TOTAL	109,254	222,716	58,714	15,688	406,372

(All figures are in £m) 2009	Retail	Wholesale	Wealth & International	Group Ops & Central Items	TOTAL
CREDIT RISK					
Exposures subject to the IRB Approach					
Advanced IRB Approach					
Corporate - Main	-	65,914	-	-	65,914
Corporate - SME	-	18,613	408	-	19,021
Central governments and central banks	-	132	-	-	132
Institutions	-	6,988	21	-	7,009
Foundation IRB Approach					
Corporate - Main	-	44,077	3,319	41	47,437
Corporate - SME	-	6,113	1	-	6,114
Corporate - Specialised lending	-	10,969	45	-	11,014
Central governments and central banks	-	251	124	502	877
Institutions	-	2,176	3	-	2,179
Retail IRB Approach					
Retail - Residential mortgages	69,581	2,569	5,077	135	77,362
Retail - Qualifying revolving retail exposures	23,854	-	-	-	23,854
Retail - Other retail	15,697	4,944	124	-	20,765
Retail - SME	-	2,522	-	-	2,522
Other IRB Approaches [1]					
Corporate - Specialised lending	-	6,080	1,752	-	7,832
Equities - Exchange traded	-	415	17	-	432
Equities - Private equity	-	2,534	-	-	2,534
Equities - Other	-	2,223	115	-	2,338
Securitisation positions [2]	-	7,828	-	-	7,828
				-	
Non credit obligation assets [3]	67	1,381	6	-	1,454
Total - IRB Approach	109,199	185,729	11,012	678	306,618
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	83	-	83
Regional governments or local authorities	-	14	11	-	25
Administrative bodies and non-commercial undertakings	-	307	16	-	323
Institutions	-	2	152	88	242
Corporates	125	31,900	20,093	616	52,734
Retail	1,103	2,069	5,364	-	8,536
Secured on real estate property	2,272	23,882	13,237	-	39,391
Past due items	1,583	4,694	7,909	-	14,186
Items belonging to regulatory high risk categories	-	4,069	-	-	4,069
Securitisation positions	-	-	87	-	87
Short term claims on institutions or corporates	-	606	26	-	632
Other items [3], [4]	2,370	8,912	1,302	12,594	25,178
Total - Standardised Approach	7,453	76,455	48,280	13,298	145,486
Total Credit Risk	116,652	262,184	59,292	13,976	452,104
COUNTERPARTY CREDIT RISK					
IRB Approach	-	5,692	-	-	5,692
Standardised Approach	-	6,535	18	-	6,553
Total Counterparty Credit Risk	-	12,227	18	-	12,245
MARKET RISK					
Internal Models Approach	-	2,104	-	-	2,104
Standardised Approach					
Interest rate position risk requirement	-	1,378	-	-	1,378
Foreign currency position risk requirement	-	128	-	-	128
Commodity position risk requirement	-	9	-	-	9
Total Market Risk	-	3,619	-	-	3,619
OPERATIONAL RISK					
Advanced Measurement Approach	11,591	7,921	3,798	1,467	24,777
Standardised Approach	349	-	141	72	562
Total Operational Risk	11,940	7,921	3,939	1,539	25,339
TOTAL	128,592	285,951	63,249	15,515	493,307

Notes

[1] Credit risk exposures subject to other IRB approaches include corporate specialised lending exposures risk weighted in accordance with supervisory slotting criteria, equity exposures risk weighted in accordance with the Simple Risk Weight Method and securitisation positions risk weighted in accordance with the Internal Assessment Approach, Ratings Based Approach and Supervisory Formula Approach.

[2] Securitisation positions exclude amounts allocated to the 1250% risk weight category. These amounts are deducted from capital, after the application of value adjustments, as opposed to being risk weighted.

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

[4] Included within other items are exposures to collective investment undertakings amounting to £40m (2009: £30m) with an associated RWA of £10m (2009: £8m).

LLOYDS BANKING GROUP PILLAR 2 CAPITAL REQUIREMENT

The Capital Resources Requirement ('CRR') is 8 per cent of risk weighted assets and represents the total capital required under Pillar 1 of the Basel II Framework.

In order to address the requirements of Pillar 2 of the Basel II framework, the FSA currently sets additional minimum requirements through the issuance of bank specific Individual Capital Guidance ('ICG'). A key input into the FSA's ICG setting process is a bank's own assessment of the amount of capital it needs, a process known as the Internal Capital Adequacy Assessment Process ('ICAAP'). The Group has been given an ICG by the FSA and maintains a formal buffer in addition to this requirement. The FSA has made it clear that each ICG remains a confidential matter between a bank and the FSA.

The LBG ICAAP supplements the Pillar 1 capital requirements for Credit Risk, Operational Risk and Market Risk (Trading Book) by assessments of the material risks not fully captured under Pillar 1. This not only has the advantage of consistency with Pillar 1 but also allows the Group to leverage the considerable investment it has made in developing the component Pillar 1 models. This includes a detailed internal review of the models, their embedding in business use and an external review of these models by the FSA.

Some of the key risks assessed within the ICAAP include:

Risks not fully captured under Pillar 1

- Concentration Risk – greater loss volatility arising from a higher level of loan default correlation than is assumed by the Pillar 1 assessment.

- Underestimation Risk – where it is considered that the Pillar 1 capital assessment underestimates the risk as a result of factors other than loan default correlation.

Risks not covered by Pillar 1

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

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

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

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

CREDIT RISK

DEFINITION

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

RISK APPETITE

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

This statement of the Group's overall appetite for credit risk is reviewed and approved annually by the Board. With the support of the Group Credit Risk Committee and Group Business Risk Committee, the Group Chief Executive allocates this risk appetite across the Group. Individual members of the Group Executive Committee ensure that credit risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. Credit risk exposures are categorised as 'retail' arising in the Retail and Wealth and International Divisions and 'wholesale' arising in the Wholesale and Wealth and International Divisions.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer as required. These commitments can take the form of loans and overdrafts, or credit instruments such as guarantees and standby, documentary and commercial letters of credit. With respect to commitments to extend credit, the Group is potentially 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 creditworthiness of customers is monitored frequently. In addition, most wholesale commitments to extend credit are contingent upon customers maintaining specific credit standards, which are regularly monitored.

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

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

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

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

Corporate Exposures

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

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

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

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

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

- the terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates; and

- as a result of the preceding factors, the primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of a broader commercial enterprise.

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

Retail Exposures

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

- Retail exposures secured by real estate collateral (i.e. residential mortgages)

- Qualifying revolving retail exposures (i.e. overdrafts and credit cards)

- Exposures to retail SMEs (i.e. retail business banking)

- Other retail exposures (i.e. unsecured personal lending)

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

Exposures to Central Governments and Central Banks

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

Exposures to Institutions

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

Equity Exposures

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

Securitisation Positions

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

MEASUREMENT

In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components: (i) the ‘probability of default’ by the 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’s rating systems assess probability of default and if permitted, exposure at default and loss given default, in order to derive an expected loss. If not permitted, regulatory prescribed exposure at default and loss given default values are used in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for loss events that have occurred at the balance sheet date, based on objective evidence of impairment. Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss models that are used for internal operational management and banking regulation purposes.

The Group assesses the probability of default of individual counterparties using internal rating models tailored to the various categories of counterparty. In its principal retail portfolios and a 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 validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. The most material rating models are approved by the Group Model Governance and Approvals Committee.

Each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between rating grades if the assessment of the counterparty 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.

MONITORING

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

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

INTENSIVE CARE OF CUSTOMERS IN DIFFICULTY

To support corporate customers that encounter difficulties during the current economic downturn, the Group has continued to expand its dedicated business support unit (BSU) model and established a central team managing this activity globally. Teams have been strengthened in both Wholesale and especially Wealth and International to deal with the rise in workloads experienced during the year as the recessionary conditions took hold both in the UK and overseas. In Wholesale three teams operate to support customers experiencing difficulties in Corporate Real Estate, Corporate and Commercial, and Specialist Finance. In Wealth and International, teams have been created in Ireland and Australia. Under this model, relationship management passes early and fully to BSU; because the BSU specialists receive the customers at an early stage in the process they have more time to develop effective solutions. The strategy is to work alongside management teams and key stakeholders to turn around businesses in distress and re-establish these as viable entities.

These specialist support teams utilise a range of techniques (including debt for equity swaps, sale of business and restructuring options) to preserve viable companies wherever possible and undertake regular reviews so that the customer receives the appropriate level of support. The reviews are also designed to ensure that support strategies continue to be relevant and are being executed.

Where a turnaround is not feasible, exposure is minimised through a combination of appropriate asset sales, restructuring and work-out strategies.

To support UK retail customers who are encountering financial difficulties, the Group has launched a cross-channel support programme. The Group provides support to customers in difficulty via trained colleagues in branches and dedicated telephony units, and via online guidance material. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities including those external to the Group, that require restructuring.

Within collections and recoveries, the sharing of best practice and alignment of policies across the Group has helped to drive more effective customer outcomes and achieve operational efficiencies. The Group has strengthened resources in collections and recoveries to help customers in distress by offering advice and access to a wider range of options such as short-term repayment plans or the government backed Homeowners Mortgage Support and Mortgage Rescue schemes.

A core element of the Group's relationship management approach is to contact customers showing signs of financial distress, discussing with them their circumstances and offering solutions to prevent their accounts falling into arrears.

In addition, the Group participates in the following UK Government ('Government') sponsored programmes for households:

– Income Support for Mortgage Interest: This is a medium-term Government initiative that provides certain defined categories of customers, principally those who are unemployed, access to a benefit scheme, paid for by the Government, which covers all or part of the interest on the mortgage. Qualifying customers are able to claim for mortgage interest on

up to £200,000 of the mortgage, and the benefit is payable for a maximum of two years. All decisions regarding an individual's eligibility and any amounts payable under the scheme rest solely with the Government. Payments are made directly to the Group by the appropriate Government department.

– Homeowner Mortgage Support Scheme: This is a medium-term Government initiative that enables borrowers affected by temporary reductions in income to access reduced payments for a period of up to two years. The Government provides a partial guarantee to the Group whilst a customer participates in the plan. Decisions on eligibility, principally whether the Group expects the borrower's earnings to recover fully, initially rest with the Group and must be made on the basis of detailed information received from an independent fee-free advisor. After a year, the customer must undergo a further full assessment made by the advice agency. The customer must pay at least 30 per cent of the interest due. Any shortfall in payments made during the period covered by the scheme is collected through increased payments over the remaining term.

– Mortgage Rescue Scheme: This is a short-term Government initiative for borrowers in difficulty and facing repossession, who would have priority for re-housing by a local authority (e.g. the elderly, disabled, single parents). Eligible customers can have their property bought in full or part by the social rented sector and then remain in their home as a tenant or shared equity partner. If the property is sold outright the mortgage is redeemed in full.

– 'Breathing space' initiative: This is a Government led initiative which requires the banking industry to allow a 'breathing space' of up to sixty days to allow borrowers in difficulty to agree a repayment plan with a debt advice charity prior to any action being taken by the bank to recover the outstanding debt.

– Delay Repossession: Under this initiative lenders will not begin repossession proceedings for at least three months when a customer is in arrears. This does not apply to fraud cases. The undertaking comes alongside an existing agreement under which mortgage providers are obliged to explore a range of options, such as payment holidays and altering the terms of a mortgage, before resorting to repossession.

– HomeBuy Direct: The HomeBuy Direct scheme covers certain newly built homes on specific housing developments across England. The scheme is provided through 'HomeBuy agents'. HomeBuy agents are housing associations that have been authorised to run schemes for people who have difficulty buying a home. Customers can only buy a home through HomeBuy Direct if their household earnings are no more than £60,000 per annum, and they cannot otherwise afford to buy a home in their area. The HomeBuy Direct scheme is open to people who rent council or housing association properties; 'key workers' in the public sector (e.g. teachers) and first-time buyers. The scheme provides up to 30 per cent of the purchase price through an equity loan that has no repayments for the first five years. After this there is an annual fee of 1.75 per cent, which will increase annually with inflation. The customer can increase their share of ownership at any time.

As well as these Government-sponsored initiatives, the Group, through its banking businesses, also operates a number of its own schemes to assist households. These include:

– Short-term reduced or nil arrangements: This is an arrangement whereby customers who are experiencing short-term difficulties may be granted a reduced (including nil) payment arrangement. This is agreed with the customer based on their individual circumstances; nil payment arrangements can be granted for up to three months and reduced payment arrangements for up to six months. There is no reduction in contractual terms for customers on these arrangements.

– Term extensions: This allows customers to extend their mortgage term in order to reduce their contractual monthly payment. The maximum term is aligned to the overall standard term limits for mortgages and there is no forbearance of any debt.

– Transfer to interest only: This allows customers who are currently on a capital and interest repayment basis to transfer to an interest only basis for a period of time (up to three years maximum) in order to reduce their contractual monthly payment.

– Contractual repayment: This scheme allows customers in arrears, but who have made sufficient payments in a six month period, to capitalise their arrears. The contractual repayment is then adjusted to provide full repayment of the loan and full interest within the agreed original term.

In addition to these household-related initiatives, the Group, through its banking businesses, participates in a number of initiatives designed to assist small and medium-sized enterprises. These include:

– The Lending Code: Introduced by the British Bankers' Association in November 2009, the Lending Code is a voluntary set of commitments and standards of good practice to ensure that lenders act fairly and reasonably in all dealings with customers.

– Statement of Principles: The Group through a number of its businesses has signed up to the Statement of Principles outlining an agreed approach to working with micro-enterprises (entities with fewer than 10 employees and having a turnover of less than €2 million). The principles include how to ensure that the right relationship is established from the start, how to help if the business faces difficulties and how businesses can work most effectively with their bank.

– As part of the Group's commitment to the Statement of Principles, it issues a Letter of Concern to customers when it has concerns about their business or the Group's relationship with them. This ensures that the customer understands the Group's concerns; the approach aims to generate early dialogue between the customer and the Group, so that a joint approach to the situation can be developed.

– Business Lending Taskforce: The Group through its banking businesses is actively involved in the recently set up Business Lending Taskforce, which has committed to 17 actions in three broad areas: (i) improving customer relationships; (ii) ensuring better access to finance; and (iii) providing better information and promoting understanding.

CREDIT RISK EXPOSURE: ANALYSIS BY EXPOSURE CLASS

As at 31 December 2010 the total credit risk exposures of the Group amounted to £878.5bn (2009: £938.0bn).

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

Exposure Class 2010	Credit Risk Exposure £m	Risk Weighted Assets £m	Average Risk Weight %	Average Credit Risk Exposure [5] £m
Exposures subject to the IRB Approach				
Advanced IRB Approach				
Corporate - Main	-	-	-	-
Corporate - SME	-	-	-	-
Central governments and central banks	-	-	-	-
Institutions	-	-	-	-
Foundation IRB Approach				
Corporate - Main	108,074	74,720	69%	114,049
Corporate - SME	27,528	20,285	74%	25,815
Corporate - Specialised lending	8,737	7,428	85%	8,810
Central governments and central banks	22,920	1,290	6%	27,670
Institutions	23,927	4,371	18%	27,029
Retail IRB Approach				
Retail - Residential mortgages	369,473	60,950	16%	368,778
Retail - Qualifying revolving retail exposures	43,049	24,765	58%	44,213
Retail - Other retail	20,550	17,690	86%	23,125
Retail - SME	2,249	2,069	92%	2,869
Other IRB Approaches [1]				
Corporate - Specialised lending	12,539	6,397	51%	11,989
Equities - Exchange traded	62	179	290%	103
Equities - Private equity	1,693	3,217	190%	1,514
Equities - Other	576	2,133	370%	589
Securitisation positions [2]	56,392	8,954	16%	60,934
Non credit obligation assets [3]	-	-	-	-
Total - IRB Approach	697,769	234,448	34%	717,487
Exposures subject to the Standardised Approach				
Central governments and central banks	40,168	60	0%	45,687
Regional governments or local authorities	65	14	22%	73
Administrative bodies and non-commercial undertakings	347	294	85%	353
Institutions	825	292	35%	709
Corporates	44,386	40,965	92%	49,537
Retail	10,103	7,560	75%	10,268
Secured on real estate property	42,925	35,582	83%	45,167
Past due items	12,641	15,286	121%	12,403
Items belonging to regulatory high risk categories	170	236	139%	1,420
Securitisation positions	8	28	350%	124
Short term claims on institutions or corporates	901	824	91%	758
Other items [3], [4]	28,194	23,351	83%	30,902
Total - Standardised Approach	180,733	124,492	69%	197,401
TOTAL	878,502	358,940	41%	914,888

Notes

[1] Credit risk exposures subject to other IRB approaches include corporate specialised lending exposures risk weighted in accordance with supervisory slotting criteria, equity exposures risk weighted in accordance with the Simple Risk Weight Method and securitisation positions risk weighted in accordance with the Internal Assessment Approach, Ratings Based Approach and Supervisory Formula Approach.

[2] Securitisation positions exclude amounts allocated to the 1250% risk weight category. These amounts are deducted from capital, after the application of value adjustments, as opposed to being risk weighted.

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

[4] Included within other items are exposures to collective investment undertakings amounting to £40m (2009: £30m) with an associated RWA of £10m (2009: £8m).

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

Exposure Class 2009	2009 Credit Risk Exposure £m	2009 Risk Weighted Assets £m	2009 Average Risk Weight %	2009 Average Credit Risk Exposure [5] £m
Exposures subject to the IRB Approach				
Advanced IRB Approach				
Corporate - Main	39,991	65,914	165%	41,206
Corporate - SME	14,344	19,021	133%	15,601
Central governments and central banks	1,052	132	13%	3,257
Institutions	21,015	7,009	33%	24,974
Foundation IRB Approach				
Corporate - Main	83,190	47,437	57%	83,162
Corporate - SME	7,224	6,114	85%	7,015
Corporate - Specialised lending	11,362	11,014	97%	10,729
Central governments and central banks	14,306	877	6%	5,487
Institutions	19,685	2,179	11%	36,664
Retail IRB Approach				
Retail - Residential mortgages	372,037	77,362	21%	376,945
Retail - Qualifying revolving retail exposures	45,200	23,854	53%	43,729
Retail - Other retail	25,289	20,765	82%	26,604
Retail - SME	3,153	2,522	80%	3,073
Other IRB Approaches [1]				
Corporate - Specialised lending	12,172	7,832	64%	12,526
Equities - Exchange traded	149	432	290%	144
Equities - Private equity	1,334	2,534	190%	1,415
Equities - Other	632	2,338	370%	854
Securitisation positions [2]	68,882	7,828	11%	78,130
Non credit obligation assets [3]	1,674	1,454	87%	1,558
Total - IRB Approach	742,691	306,618	41%	773,073
Exposures subject to the Standardised Approach				
Central governments and central banks	35,353	83	0%	39,720
Regional governments or local authorities	82	25	30%	102
Administrative bodies and non-commercial undertakings	373	323	87%	392
Institutions	668	242	36%	687
Corporates	55,980	52,734	94%	67,806
Retail	10,604	8,536	80%	11,971
Secured on real estate property	47,248	39,391	83%	49,514
Past due items	12,118	14,186	117%	10,965
Items belonging to regulatory high risk categories	1,197	4,069	340%	1,113
Securitisation positions	230	87	38%	132
Short term claims on institutions or corporates	632	632	100%	1,171
Other items [3], [4]	30,780	25,178	82%	25,325
Total - Standardised Approach	195,265	145,486	75%	208,898
TOTAL	937,956	452,104	48%	981,971

Key Movements

- Following approval from the FSA, all exposures previously subject to the Advanced IRB Approach have been transferred to the Foundation IRB Approach and risk weighted accordingly. In addition, under the Group's integrated IRB waiver permission all non credit obligation assets previously disclosed under the IRB Approach have been transferred to other items under the Standardised Approach.

- The reduction in underlying corporate and institutions IRB exposures during the year primarily reflects deleveraging by Wholesale customers, continuing active de-risking of the balance sheet and a reduction in loans and advances to banks as Wholesale refocused the balance sheet. Within Corporate Markets demand for new corporate lending and refinancing of exiting facilities were more than offset by the level of maturities, reflecting a continued trend of subdued corporate lending, customer deleveraging and asset sales.

- Overall, exposures subject to the Retail IRB Approach have reduced during the year following reduced consumer demand for credit and portfolio management actions, including limit reductions. Related RWAs have reduced as a result of both the reduction in exposure and the recalibration of Retail residential mortgage downturn LGD rates, which has resulted in a lowering of the average risk weight from 21% to 16%.

- The reduction in average risk weight for corporate specialised lending exposures (Other IRB) from 64% to 51% primarily reflects an increase in the level of exposures categorised as default following further downgrades within the Irish property development portfolio. Default exposures do not attract a risk weight but are instead converted into an expected loss amount at a rate of 50%.

- Securitisations positions subject to the IRB Approach reduced during the year as a result of either selling down or not replenishing total holdings after amortisations or maturities.

- Standardised corporates and secured on real estate property exposures reduced during the year for reasons similar to those described above for corporate IRB exposures. In addition to the Wholesale activities, reductions in related portfolios within Wealth and International also contributed to the overall reduction as a result of the focus on de-risking and right-sizing the Wealth and International balance sheet, increased focus on key Group relationships and reduced concentration in Commercial Real Estate.

CREDIT RISK EXPOSURE: ANALYSIS BY DIVISION

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

Division	Risk Weight Approach	2010 Credit Risk Exposure £m	2009 Credit Risk Exposure £m
Retail	IRB	412,665	421,405
	Standardised	9,813	11,415
Wholesale	IRB	258,827	292,020
	Standardised	90,088	107,190
Wealth & International	IRB	17,378	24,404
	Standardised	50,347	56,161
Group Ops & Central Items	IRB	8,899	4,862
	Standardised	30,485	20,499
Total		878,502	937,956

CREDIT RISK EXPOSURE: ANALYSIS BY INDUSTRY

Credit risk exposures as at 31 December 2010, analysed by major industrial sector, are provided in the table below.

(All figures are in £m)	2010 Agriculture, forestry and fishing	2010 Energy and water supply	2010 Manufacturing	2010 Construction	2010 Transport, distribution and hotels	2010 Postal and comms	2010 Property companies	2010 Financial, business and other services	2010 Personal: Mortgages	2010 Personal: Other	2010 Lease financing	2010 Hire purchase	2010 TOTAL
Exposures subject to the IRB Approach													
Advanced IRB Approach													
Corporate - Main	-	-	-	-	-	-	-	-	-	-	-	-	-
Corporate - SME	-	-	-	-	-	-	-	-	-	-	-	-	-
Central governments and central banks	-	-	-	-	-	-	-	-	-	-	-	-	-
Institutions	-	-	-	-	-	-	-	-	-	-	-	-	-
Foundation IRB Approach													
Corporate - Main	644	2,492	12,680	6,940	15,302	1,658	16,989	47,870	271	-	2,710	518	108,074
Corporate - SME	857	11	2,063	1,464	4,285	368	10,212	7,274	27	-	637	330	27,528
Corporate - Specialised lending	19	-	-	187	75	-	7,679	777	-	-	-	-	8,737
Central governments and central banks	-	-	-	-	-	-	-	22,920	-	-	-	-	22,920
Institutions	-	-	-	-	-	-	18	23,419	-	-	490	-	23,927
Retail IRB Approach													
Retail - Residential mortgages	901	2	207	314	1,202	23	2,939	1,164	362,720	1	-	-	369,473
Retail - Qualifying revolving retail exposures	-	-	-	-	-	-	-	-	-	43,049	-	-	43,049
Retail - Other retail	1	-	1	1	6	1	1	6	-	15,793	2	4,738	20,550
Retail - SME	223	1	237	443	721	22	252	345	-	5	-	-	2,249
Other IRB Approaches													
Corporate - Specialised lending	1	722	89	594	2,375	45	5,850	2,015	-	-	848	-	12,539
Equities - Exchange traded	-	-	-	-	-	-	3	59	-	-	-	-	62
Equities - Private equity	-	-	-	-	-	-	73	1,620	-	-	-	-	1,693
Equities - Other	-	-	39	-	3	-	111	423	-	-	-	-	576
Securitisation positions	250	-	111	112	1,012	17	651	54,239	-	-	-	-	56,392
Total – IRB Approach	2,896	3,228	15,427	10,055	24,981	2,134	44,778	162,131	363,018	58,848	4,687	5,586	697,769
Exposures subject to the Standardised Approach													
Central governments and central banks	-	-	-	-	-	-	-	40,160	-	-	8	-	40,168
Regional governments or local authorities	-	-	-	-	-	-	-	43	-	-	22	-	65
Administrative bodies and non-commercial undertakings	-	67	-	-	-	-	-	267	-	-	12	1	347
Institutions	-	-	-	-	-	-	16	808	-	-	1	-	825
Corporates	1,541	1,370	2,579	2,476	12,052	2,048	4,295	15,103	2	1,410	1,295	215	44,386
Retail	1,346	8	171	246	144	68	134	1,230	-	5,613	467	676	10,103
Secured on real estate property	4	-	67	384	632	27	24,317	1,444	15,204	1	751	94	42,925
Past due items	158	61	383	351	2,598	179	5,672	968	1,512	605	121	33	12,641
Items belonging to regulatory high risk categories	-	-	-	-	7	-	6	157	-	-	-	-	170
Securitisation positions	-	-	-	-	-	-	-	-	8	-	-	-	8
Short term claims on institutions or corporates	132	2	17	18	66	1	33	595	-	-	33	4	901
Total – Standardised Approach	3,181	1,508	3,217	3,475	15,499	2,323	34,473	60,775	16,726	7,629	2,710	1,023	152,539
Total	6,077	4,736	18,644	13,530	40,480	4,457	79,251	222,906	379,744	66,477	7,397	6,609	850,308
Non credit obligation assets / Other items													28,194
Total Credit Risk Exposure													878,502

(All figures are in £m)	2009 Agriculture, forestry and fishing	2009 Energy and water supply	2009 Manufacturing	2009 Construction	2009 Transport, distribution and hotels	2009 Postal and comms	2009 Property companies	2009 Financial, business and other services	2009 Personal: Mortgages	2009 Personal: Other	2009 Lease financing	2009 Hire purchase	2009 TOTAL
Exposures subject to the IRB Approach													
Advanced IRB Approach													
Corporate - Main	2	1,799	2,982	4,421	7,504	-	10,980	11,958	345	-	-	-	39,991
Corporate - SME	31	281	1,113	972	3,409	-	4,375	4,113	44	6	-	-	14,344
Central governments and central banks	-	-	-	-	-	-	-	1,052	-	-	-	-	1,052
Institutions	-	-	-	-	-	-	-	21,015	-	-	-	-	21,015
Foundation IRB Approach													
Corporate - Main	341	1,973	11,478	2,734	9,482	1,618	10,888	41,266	-	-	3,128	282	83,190
Corporate - SME	310	6	780	144	729	233	2,766	1,623	-	-	23	610	7,224
Corporate - Specialised lending	3	-	1	266	92	-	10,037	963	-	-	-	-	11,362
Central governments and central banks	-	1	1	-	-	-	-	14,304	-	-	-	-	14,306
Institutions	-	-	-	-	-	-	-	18,719	-	-	966	-	19,685
Retail IRB Approach													
Retail - Residential mortgages	777	1	176	262	944	16	1,916	892	367,052	1	-	-	372,037
Retail - Qualifying revolving retail exposures	-	-	-	-	-	-	-	-	-	45,200	-	-	45,200
Retail - Other retail	1	-	2	2	10	-	2	8	-	20,003	219	5,042	25,289
Retail - SME	231	2	238	456	741	23	239	863	-	135	-	225	3,153
Other IRB Approaches													
Corporate - Specialised lending	2	460	82	631	2,017	12	5,967	2,129	-	-	872	-	12,172
Equities - Exchange traded	-	-	1	-	2	-	-	146	-	-	-	-	149
Equities - Private equity	-	-	-	-	-	-	-	1,334	-	-	-	-	1,334
Equities - Other	-	43	43	-	8	-	65	473	-	-	-	-	632
Securitisation positions	305	1	135	160	1,179	22	1,514	65,565	1	-	-	-	68,882
Total – IRB Approach	2,003	4,567	17,032	10,048	26,117	1,924	48,749	186,423	367,442	65,345	5,208	6,159	741,017
Exposures subject to the Standardised Approach													
Central governments and central banks	-	-	-	-	-	-	-	35,279	-	-	74	-	35,353
Regional governments or local authorities	-	-	-	-	-	-	-	40	-	-	42	-	82
Administrative bodies and non-commercial undertakings	-	66	-	-	-	-	-	276	-	-	31	-	373
Institutions	-	-	1	88	-	-	-	579	-	-	-	-	668
Corporates	1,521	2,106	3,252	6,532	12,127	1,555	6,129	15,549	1,256	825	4,258	870	55,980
Retail	1,298	259	77	426	177	6	423	564	5	5,700	407	1,262	10,604
Secured on real estate property	9	-	72	402	700	-	28,468	1,916	15,681	-	-	-	47,248
Past due items	178	94	457	1,768	2,551	-	2,554	1,948	1,729	662	68	109	12,118
Items belonging to regulatory high risk categories	-	-	272	69	209	-	51	596	-	-	-	-	1,197
Securitisation positions	-	-	-	-	-	-	222	-	8	-	-	-	230
Short term claims on institutions or corporates	113	82	28	5	72	-	184	131	17	-	-	-	632
Total – Standardised Approach	3,119	2,607	4,159	9,290	15,836	1,561	38,031	56,878	18,696	7,187	4,880	2,241	164,485
Total	5,122	7,174	21,191	19,338	41,953	3,485	86,780	243,301	386,138	72,532	10,088	8,400	905,502
Non credit obligation assets / Other items													32,454
Total Credit Risk Exposure													937,956

CREDIT RISK EXPOSURE: ANALYSIS BY GEOGRAPHY

Credit risk exposures as at 31 December 2010, analysed by geographical area based on the country of residence of the customer, are provided in the table below.

(All figures are in £m)	2010 United Kingdom	2010 Rest of Europe	2010 United States of America	2010 Asia-Pacific	2010 Other	2010 TOTAL
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	-	-	-	-	-	-
Corporate - SME	-	-	-	-	-	-
Central governments and central banks	-	-	-	-	-	-
Institutions	-	-	-	-	-	-
Foundation IRB Approach						
Corporate - Main	81,139	11,376	12,225	699	2,635	108,074
Corporate - SME	27,147	131	133	44	73	27,528
Corporate - Specialised lending	6,757	1,380	85	5	510	8,737
Central governments and central banks	6	11,613	10,900	78	323	22,920
Institutions	5,167	11,536	4,389	1,659	1,176	23,927
Retail IRB Approach						
Retail - Residential mortgages	363,189	6,284	-	-	-	369,473
Retail - Qualifying revolving retail exposures	43,049	-	-	-	-	43,049
Retail - Other retail	20,319	230	-	-	1	20,550
Retail - SME	2,249	-	-	-	-	2,249
Other IRB Approaches						
Corporate - Specialised lending	3,657	5,761	2,133	322	666	12,539
Equities - Exchange traded	29	-	-	1	32	62
Equities - Private equity	1,209	311	173	-	-	1,693
Equities - Other	509	30	30	-	7	576
Securitisation positions [1]	17,983	10,861	20,466	376	6,706	56,392
Total – IRB Approach	572,409	59,513	50,534	3,184	12,129	697,769
Exposures subject to the Standardised Approach						
Central governments and central banks	36,337	3,301	-	473	57	40,168
Regional governments or local authorities	44	-	-	20	1	65
Administrative bodies and non-commercial undertakings	280	1	-	65	1	347
Institutions	397	149	177	66	36	825
Corporates	21,036	11,153	2,975	7,417	1,805	44,386
Retail	5,323	813	145	3,395	427	10,103
Secured on real estate property	23,962	14,457	191	3,420	895	42,925
Past due items	3,301	5,417	504	3,114	305	12,641
Items belonging to regulatory high risk categories	36	40	2	-	92	170
Securitisation positions	-	8	-	-	-	8
Short term claims on institutions or corporates	785	82	1	18	15	901
Total – Standardised Approach	91,501	35,421	3,995	17,988	3,634	152,539
Total	663,910	94,934	54,529	21,172	15,763	850,308
Non credit obligation assets / Other items						28,194
Total Credit Risk Exposure						878,502

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

(All figures are in £m)	2009 United Kingdom	2009 Rest of Europe	2009 United States of America	2009 Asia-Pacific	2009 Other	2009 TOTAL
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	36,233	80	3,678	-	-	39,991
Corporate - SME	14,140	52	152	-	-	14,344
Central governments and central banks	36	938	-	78	-	1,052
Institutions	2,505	10,918	5,606	1,180	806	21,015
Foundation IRB Approach						
Corporate - Main	54,771	11,918	12,060	748	3,693	83,190
Corporate - SME	7,159	36	6	-	23	7,224
Corporate - Specialised lending	9,435	1,380	100	49	398	11,362
Central governments and central banks	6	9,651	2,132	2,266	251	14,306
Institutions	4,479	11,224	2,298	741	943	19,685
Retail IRB Approach						
Retail - Residential mortgages	365,321	6,716	-	-	-	372,037
Retail - Qualifying revolving retail exposures	45,200	-	-	-	-	45,200
Retail - Other retail	24,965	324	-	-	-	25,289
Retail - SME	3,153	-	-	-	-	3,153
Other IRB Approaches						
Corporate - Specialised lending	3,250	5,155	2,984	326	457	12,172
Equities - Exchange traded	22	38	59	1	29	149
Equities - Private equity	1,015	180	139	-	-	1,334
Equities - Other	530	82	7	1	12	632
Securitisation positions [1]	27,837	11,999	25,564	929	2,553	68,882
Total – IRB Approach	600,057	70,691	54,785	6,319	9,165	741,017
Exposures subject to the Standardised Approach						
Central governments and central banks	33,126	585	-	1,564	78	35,353
Regional governments or local authorities	70	-	-	11	1	82
Administrative bodies and non-commercial undertakings	307	-	-	63	3	373
Institutions	369	78	58	126	37	668
Corporates	22,838	15,059	4,421	11,423	2,239	55,980
Retail	5,703	1,299	330	2,827	445	10,604
Secured on real estate property	28,200	16,454	167	1,555	872	47,248
Past due items	4,057	5,236	679	2,057	89	12,118
Items belonging to regulatory high risk categories	1,084	-	2	-	111	1,197
Securitisation positions	222	8	-	-	-	230
Short term claims on institutions or corporates	375	95	123	-	39	632
Total – Standardised Approach	96,351	38,814	5,780	19,626	3,914	164,485
Total	696,408	109,505	60,565	25,945	13,079	905,502
Non credit obligation assets / Other items						32,454
Total Credit Risk Exposure						937,956

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

CREDIT RISK EXPOSURE: ANALYSIS BY RESIDUAL MATURITY

Credit risk exposures as at 31 December 2010, analysed by residual contractual maturity, are provided in the table below.

(All figures are in £m)	2010 On demand	2010 Repayable in 3 months or less	2010 Repayable between 3 months and 1 year	2010 Repayable between 1 and 5 years	2010 Repayable over 5 years or undated	2010 TOTAL
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	-	-	-	-	-	-
Corporate - SME	-	-	-	-	-	-
Central governments and central banks	-	-	-	-	-	-
Institutions	-	-	-	-	-	-
Foundation IRB Approach						
Corporate - Main	7,726	9,778	14,967	54,953	20,650	108,074
Corporate - SME	3,020	2,544	3,216	9,596	9,152	27,528
Corporate - Specialised lending	221	445	1,228	5,129	1,714	8,737
Central governments and central banks	401	14,291	56	2,489	5,683	22,920
Institutions	281	7,604	2,635	7,753	5,654	23,927
Retail IRB Approach						
Retail - Residential mortgages	2,099	499	4,296	18,693	343,886	369,473
Retail - Qualifying revolving retail exposures	43,049	-	-	-	-	43,049
Retail - Other retail	307	919	2,296	13,718	3,310	20,550
Retail - SME	1,476	6	26	331	410	2,249
Other IRB Approaches						
Corporate - Specialised lending	336	515	1,215	6,416	4,057	12,539
Equities - Exchange traded	-	-	-	32	30	62
Equities - Private equity	-	-	5	34	1,654	1,693
Equities - Other	-	-	-	2	574	576
Securitisation positions	139	902	11,514	8,061	35,776	56,392
Total – IRB Approach	59,055	37,503	41,454	127,207	432,550	697,769
Exposures subject to the Standardised Approach						
Central governments and central banks	23,107	2,056	1,091	176	13,738	40,168
Regional governments or local authorities	-	-	2	59	4	65
Administrative bodies and non-commercial undertakings	-	2	65	136	144	347
Institutions	84	507	52	92	90	825
Corporates	2,005	1,481	4,149	21,864	14,887	44,386
Retail	1,138	398	577	5,174	2,816	10,103
Secured on real estate property	1,105	3,426	3,394	14,126	20,874	42,925
Past due items	870	1,326	1,693	4,723	4,029	12,641
Items belonging to regulatory high risk categories	-	-	-	161	9	170
Securitisation positions	-	-	-	-	8	8
Short term claims on institutions or corporates	266	635	-	-	-	901
Total – Standardised Approach	28,575	9,831	11,023	46,511	56,599	152,539
Total	87,630	47,334	52,477	173,718	489,149	850,308
Non credit obligation assets / Other items						28,194
Total Credit Risk Exposure						878,502

(All figures are in £m)	2009 On demand	2009 Repayable in 3 months or less	2009 Repayable between 3 months and 1 year	2009 Repayable between 1 and 5 years	2009 Repayable over 5 years or undated	2009 TOTAL
Exposures subject to the IRB Approach						
Advanced IRB Approach						
Corporate - Main	2,173	2,137	3,429	22,758	9,494	39,991
Corporate - SME	1,805	2,213	2,029	4,459	3,838	14,344
Central governments and central banks	-	-	264	735	53	1,052
Institutions	89	1,459	1,658	13,112	4,697	21,015
Foundation IRB Approach						
Corporate - Main	6,299	7,936	8,859	42,806	17,290	83,190
Corporate - SME	828	150	469	3,153	2,624	7,224
Corporate - Specialised lending	640	728	659	6,714	2,621	11,362
Central governments and central banks	42	8,405	266	544	5,049	14,306
Institutions	115	6,915	6,350	4,517	1,788	19,685
Retail IRB Approach						
Retail - Residential mortgages [1]	1,958	398	3,807	17,358	348,516	372,037
Retail - Qualifying revolving retail exposures	45,200	-	-	-	-	45,200
Retail - Other retail	403	1,001	2,552	15,966	5,367	25,289
Retail - SME	1,936	25	101	620	471	3,153
Other IRB Approaches						
Corporate - Specialised lending	264	1,208	1,318	5,749	3,633	12,172
Equities - Exchange traded	-	-	-	94	55	149
Equities - Private equity	-	-	-	41	1,293	1,334
Equities - Other	-	-	-	33	599	632
Securitisation positions	110	2,360	14,976	7,752	43,684	68,882
Total – IRB Approach	61,862	34,935	46,737	146,411	451,072	741,017
Exposures subject to the Standardised Approach						
Central governments and central banks	27,508	2,115	38	111	5,581	35,353
Regional governments or local authorities	-	1	1	80	-	82
Administrative bodies and non-commercial undertakings	1	1	64	139	168	373
Institutions	131	366	63	106	2	668
Corporates	1,537	3,092	5,104	28,100	18,147	55,980
Retail	1,510	328	524	5,429	2,813	10,604
Secured on real estate property	395	3,469	4,534	15,692	23,158	47,248
Past due items	773	1,822	701	3,966	4,856	12,118
Items belonging to regulatory high risk categories	-	103	-	2	1,092	1,197
Securitisation positions	-	-	-	222	8	230
Short term claims on institutions or corporates	249	383	-	-	-	632
Total – Standardised Approach	32,104	11,680	11,029	53,847	55,825	164,485
Total	93,966	46,615	57,766	200,258	506,897	905,502
Non credit obligation assets / Other items						32,454
Total Credit Risk Exposure						937,956

[1] The residual contractual maturity profile of residential mortgages has been restated to reflect amendments made to the allocation methodology during 2010, following further integration of the heritage banks' retail functions.

PAST DUE EXPOSURES, IMPAIRED EXPOSURES AND IMPAIRMENT PROVISIONS

DEFINITION

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

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

ACCOUNTING POLICY

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

Assets accounted for at amortised cost

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

Where such an event has had an impact on the estimated future cash flows of the financial asset or group of financial assets, an impairment allowance is recognised. The amount of impairment allowance is the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If the asset has a variable rate of interest, the discount rate used for measuring the impairment allowance is the current effective interest rate.

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an effective interest rate basis, on the asset's carrying value net of impairment provisions. 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.

Impairment allowances are assessed individually for financial assets that are individually significant. Such individual assessment is used primarily for the Group's wholesale lending portfolios in the Wholesale and Wealth and International divisions. Impairment allowances for portfolios of smaller balance homogenous loans such as most residential mortgages, personal loans and credit card balances in the Group's retail portfolios in both the Retail and Wealth and International divisions 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.

Individual Assessment

In respect of individually significant financial assets in the Group's wholesale lending portfolios, assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed on a watch list where greater monitoring is undertaken and any adverse or potentially adverse impact on ability to repay is used in assessing whether an asset should be transferred to a dedicated Business Support Unit. Specific examples of trigger events that would lead to the initial recognition of impairment allowances against lending to corporate borrowers (or the recognition of additional impairment allowances) include (i) trading losses, loss of business or major customer of a borrower, (ii) material breaches of the terms and conditions of a loan facility, including non-payment of interest or principal, or a fall in the value of security such that it is no longer considered adequate, (iii) disappearance of an active market because of financial difficulties, or (iv) restructuring a facility with preferential terms to aid recovery of the lending (such as a debt for equity swap).

For such individually identified financial assets, a review is undertaken of the expected future cash flows which requires significant management judgement as to the amount and timing of such cash flows. Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of costs to realise, whether or not foreclosure or realisation of the collateral is probable.

For impaired debt instruments which are held at amortised cost, 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.

Collective Assessment

In respect of portfolios of smaller balance, homogenous loans, the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors such as the type of asset, 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.

Generally, the impairment trigger used within the impairment calculation for a loan, or group of loans, is when they reach a pre-defined level of delinquency or where the customer is bankrupt. Loans where the Group provides arrangements that forgive a portion of interest or principal are also deemed to be impaired and loans that are originated to refinance currently impaired assets are also defined as impaired.

In respect of the Group's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those six months or more in arrears (or where the borrower is bankrupt or is in possession). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics noted above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. 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.

The collective provision also includes provision for inherent losses, that is losses that have been incurred but have not been identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. An assessment is made, based on statistical techniques, of the likelihood of each account becoming recognised as impaired within an emergence period, with the economic loss that each portfolio is likely to generate were it to become impaired. The emergence period is the time between the loss event and the date the impairment is recognised. The emergence period is determined by local management for each portfolio. In general the periods used across the Group vary between one month and twelve months based on historical experience.

Loan Renegotiations and Forebearance

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. There are a number of different types of loan renegotiation, including the capitalisation of arrears, payment holidays, interest rate adjustments and extensions of the due date of payment. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with the revised terms. In other cases, renegotiation may lead to a new agreement, which is treated as a new loan.

Write Offs

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 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.

Debt for Equity Exchanges

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

Available-for-sale financial assets

The Group assesses, at each balance sheet date, whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether

there has been a significant or prolonged decline in the fair value of the asset below its cost. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised, is reclassified from equity to the income statement. For impaired debt instruments, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows; a reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to other comprehensive income. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

MANAGING IMPAIRED EXPOSURES AND IMPAIRMENT PROVISIONS

Group Provisioning Policy

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

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

Adequacy reviews

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

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

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

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

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

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

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

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

Reporting

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

At key financial reporting period ends, an Impairment Adequacy Report, summarising individual and collective impairment provisions, write-offs and other impairment provisioning issues, including risk elements and results, is submitted to each of the Risk Committee and the Audit Committee. The Group Credit Risk Committee and Group Risk monitor impairment provisions on a continuous basis throughout the year.

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

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

In addition, comprehensive monthly reporting packs are produced by the Divisional Business Support Units, which actively manage distressed assets and by Collections and Recoveries units within Retail Division.

The Group reviews regularly, but at least annually, its provision forecast against actual experience to identify whether its policies resulted in over or under provisioning across the economic cycle. The responsibility for the review rests with Divisions who report half yearly to the Group Credit Risk Committee and Audit Committee on its findings and recommendation.

ANALYSIS OF PAST DUE AND IMPAIRED LOANS AND ADVANCES TO CUSTOMERS

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

As at 31 December 2010, past due but not impaired exposures in respect of loans and advances to customers amounted to £17.9bn (2009: £19.6bn). Impaired exposures in respect of loans and advances to customers amounted to £64.6bn (2009: £58.8bn), of which £7.9bn (2009: £9.1bn) were classified as 'impaired – no provision required' and the remaining £56.7bn (2009: £49.7bn) as 'impaired – provision held'.

Analysis by Industry

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2010, by major industrial sector, is provided in the table below.

	Past due but not impaired		Impaired	
	2010 £m	2010 As a % of credit risk exposure	2010 £m	2010 As a % of credit risk exposure
Agriculture, forestry and fishing	96	1.58%	257	4.23%
Energy and water supply	15	0.32%	241	5.09%
Manufacturing	239	1.28%	2,412	12.94%
Construction	101	0.75%	2,811	20.78%
Transport, distribution and hotels	500	1.24%	7,704	19.03%
Postal and communications	18	0.40%	59	1.32%
Property companies	1,708	2.16%	29,459	37.17%
Financial, business and other services	743	0.33%	8,401	3.77%
Personal: Mortgages	13,215	3.48%	7,780	2.05%
Personal: Other	927	1.40%	4,595	6.91%
Lease financing	122	1.65%	302	4.08%
Hire purchase	247	3.74%	585	8.85%
Total	17,931	2.04%	64,606	7.35%

	Past due but not impaired		Impaired	
	2009 £m	2009 As a % of credit risk exposure	2009 £m	2009 As a % of credit risk exposure
Agriculture, forestry and fishing	107	2.09%	143	2.79%
Energy and water supply	113	1.58%	952	13.27%
Manufacturing	85	0.40%	2,492	11.76%
Construction	403	2.08%	4,355	22.52%
Transport, distribution and hotels	993	2.37%	7,211	17.19%
Postal and communications	3	0.09%	26	0.75%
Property companies	2,788	3.21%	19,911	22.94%
Financial, business and other services	715	0.29%	7,732	3.18%
Personal: Mortgages	12,587	3.26%	7,952	2.06%
Personal: Other	1,532	2.11%	7,056	9.73%
Lease financing	41	0.41%	196	1.94%
Hire purchase	211	2.51%	807	9.61%
Total	19,578	2.09%	58,833	6.27%

Analysis by Geography

An analysis of past due but not impaired loans and advances to customers and impaired loans and advances to customers as at 31 December 2010, by country of residence of the customer, is provided in the table below.

	Past due but not impaired		Impaired	
	2010 £m	2010 As a % of credit risk exposure	2010 £m	2010 As a % of credit risk exposure
United Kingdom	15,745	2.37%	41,499	6.25%
Rest of Europe	1,669	1.76%	16,125	16.99%
United States of America	9	0.02%	1,902	3.49%
Asia-Pacific	420	1.98%	4,696	22.18%
Other	88	0.56%	384	2.44%
Total	17,931	2.04%	64,606	7.35%

	Past due but not impaired		Impaired	
	2009 £m	2009 As a % of credit risk exposure	2009 £m	2009 As a % of credit risk exposure
United Kingdom	16,632	2.39%	43,526	6.25%
Rest of Europe	2,504	2.29%	10,238	9.35%
United States of America	67	0.11%	2,776	4.58%
Asia-Pacific	300	1.16%	2,084	8.03%
Other	75	0.57%	209	1.60%
Total	19,578	2.09%	58,833	6.27%

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

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

The movement in impairment provisions, from 31 December 2009 to 31 December 2010, in respect of loans and advances to customers is provided below.

	£m
At 31 December 2009	14,801
Exchange and other adjustments	(2)
Advances written off	(6,966)
Recoveries of advances written off in previous years	216
Unwinding of discount	(403)
Charge to the income statement	10,727
At 31 December 2010 (Lloyds Banking Group plc Annual Report and Accounts 2010, p.192)	18,373

	£m
At 31 December 2008	3,459
Exchange and other adjustments	95
Advances written off	(4,200)
Recoveries of advances written off in previous years	110
Unwinding of discount	(446)
Charge to the income statement	15,783
At 31 December 2009 (Lloyds Banking Group plc Annual Report and Accounts 2010, p.192)	14,801

Analysis by Industry

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

	2010 Impairment provisions £m	2010 Net charge £m	2010 Advances written off £m
Agriculture, forestry and fishing	16	20	47
Energy and water supply	108	17	36
Manufacturing	540	203	385
Construction	588	463	365
Transport, distribution and hotels	1,400	800	742
Postal and communications	50	32	-
Property companies	8,546	4,114	846
Financial, business and other services	2,451	1,293	881
Personal: Mortgages	526	196	145
Personal: Other	3,541	3,431	3,344
Lease financing	287	57	15
Hire purchase	320	101	160
Total	18,373	10,727	6,966

	2009 Impairment provisions £m[2]	2009 Net charge £m[2]	2009 Advances written off £m
Agriculture, forestry and fishing	33	29	5
Energy and water supply	120	105	28
Manufacturing	709	747	148
Construction	527	842	336
Transport, distribution and hotels	1,391	1,553	80
Postal and communications	15	24	9
Property companies	5,394	5,418	51
Financial, business and other services	2,108	1,913	308
Personal: Mortgages	464	343	77
Personal: Other	3,419	4,314	3,063
Lease financing	244	261	26
Hire purchase	377	234	69
Total	14,801	15,783	4,200

[1] Extracted from the 'Summary of Loan Loss Experience' analysis presented on pages 80 to 84 of the 2010 Form 20-F.

[2] During 2010, the Group reviewed the detailed breakdown of movements in impairment allowances and some disclosures for the year ended 31 December 2009 have been reclassified to conform with the current year presentation.

Analysis by Geography

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

	2010 Impairment provisions £m	2010 Net charge £m	2010 Advances written off £m
United Kingdom	18,626	6,771	8,784
Rest of Europe	7,705	4,531	95
United States of America	779	120	666
Asia-Pacific	2,513	1,428	557
Other	12	108	-
	29,635	12,958	10,102
Fair value and other adjustments[1]	(11,262)	(2,231)	(3,136)
Total	18,373	10,727	6,966

	2009 Impairment provisions £m	2009 Net charge £m	2009 Advances written off £m
United Kingdom	18,574	15,447	9,362
Rest of Europe	4,100	3,468	297
United States of America	2,134	2,240	442
Asia-Pacific	985	980	282
Other	195	175	2
	25,988	22,310	10,385
Fair value and other adjustments[1]	(11,187)	(6,527)	(6,185)
Total	14,801	15,783	4,200

[1] Analysis of closing impairment provisions, the net charge to the income statement and advances written off in respect of loans and advances to customers, by country of residence of the customer, has been presented prior to the application of fair value and other adjustments. Such adjustments are not analysed on a geographical basis within the business. Further details on the fair value and other adjustments applied in respect of impairment provisions can be found on p.255 of the 2010 Lloyds Banking Group plc Annual Report and Accounts.

IMPAIRED LOANS AND ADVANCES TO BANKS

As at 31 December 2010, loans and advances to banks amounting to £20m (2009: £153m) were deemed to be impaired. Impairment provisions held in respect of these impaired balances amounted to £20m (2009: £149m). An analysis of the movement in impairment provisions, from 31 December 2009 to 31 December 2010, is provided below.

	£m
At 31 December 2009	149
Exchange and other adjustments	(5)
Advances written off	(111)
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Release to the income statement	(13)
At 31 December 2010	20

(Lloyds Banking Group plc Annual Report and Accounts 2010, p.192)

	£m
At 31 December 2008	135
Exchange and other adjustments	17
Advances written off	-
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Release to the income statement	(3)
At 31 December 2009	149

(Lloyds Banking Group plc Annual Report and Accounts 2010, p.192)

IMPAIRED DEBT SECURITIES CLASSIFIED AS LOANS AND RECEIVABLES

As at 31 December 2010, impairment provisions held in respect of debt securities classified as loans and receivables amounted to £558m (2009: £430m). An analysis of the movement in impairment provisions, from 31 December 2009 to 31 December 2010, is provided below.

	£m
At 31 December 2009	430
Exchange and other adjustments	119
Advances written off	(48)
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	57
At 31 December 2010	558

(Lloyds Banking Group plc Annual Report and Accounts 2010, p.192)

	£m
At 31 December 2008	133
Exchange and other adjustments	49
Advances written off	-
Recoveries of advances written off in previous years	-
Unwinding of discount	-
Charge to the income statement	248
At 31 December 2009	430

(Lloyds Banking Group plc Annual Report and Accounts 2009, p.192)

FACTORS IMPACTING LOSS EXPERIENCE

The Group achieved a significant reduction in the impairment charge in 2010, with deterioration in Ireland more than offset by substantial improvements elsewhere in the Group, particularly in the Wholesale division.

Impaired loans increased by 10 per cent to £64.6bn, driven by an increase in impaired loans in International, partially offset by decreases in Retail and Wholesale facilitated by improving economic conditions and, in Wholesale, also as a result of write-offs of irrecoverable assets and the sale of previously impaired assets.

In Retail, the improvement in credit performance was faster than expected a year ago. The decrease in impairment charge reflected the improved quality of new business and effective portfolio management and the continuing slow recovery of the economy.

The lower secured impairment charge reflected reduced impaired loan levels and improved arrears in the first half of 2010, although in the second half, and particularly in the last quarter, the Group saw some signs of strain, with fewer customers returning their accounts to order than was the case six months ago. House prices fell slightly in the year and the proportion of the mortgage portfolio with an indexed loan-to-value of greater than 100 per cent was broadly stable at 13 per cent. The value of the portfolio with an indexed loan-to-value greater than 100 per cent and more than three months in arrears has increased slightly by £0.2bn and is now £3.2bn, representing 0.9 per cent of the portfolio. The number of mortgage customers new to arrears has also remained relatively stable in the last twelve months, and is now

well below the peak experienced in the second half of 2008. However, as a result of the early signs of strain in the second half of the year and the subdued economic environment, the Group expects to see an increase in the secured impairment charge in 2011.

The unsecured impairment charge decreased by 29 per cent, reflecting continued improving portfolio trends resulting from the Group's prudent risk appetite, management actions taken over the past two years, and stable unemployment. Unsecured impaired loans decreased by £0.8bn to £3.0bn as a result of fewer cases going into arrears, improved quality of new business and increased write off of impaired loans. Impairment provisions as a percentage of impaired loans decreased, driven largely by relatively highly provided assets being written off combined with more stringent criteria for unsecured collections repayment plans.

Within Wholesale there was a significant reduction in the impairment charge. The decrease in this period generally reflects the significant actions which were taken in the first half of 2009 on the heritage HBOS portfolios (including the identification of large impairments post the HBOS acquisition, especially in corporate real estate, real estate related and Corporate (UK and US) portfolios), together with the stabilising UK and US economic environment in 2010, a low interest rate environment helping to maintain defaults at a lower level and a number of write backs due to asset disposals.

In Wealth and International, impairment charges increased significantly reflecting increasing impairment charges in corporate and real estate in Ireland and Australia. The level of losses continues to be dominated by the economic environment in Ireland, and to a lesser extent has also been influenced by the performance of specific areas of the Australian economy.

After the release of the Interim Management Statement on 2 November 2010, the Group saw a further significant deterioration in market conditions in Ireland, with concerns over the country's fiscal position leading ultimately to the approval of its application for EU-IMF financial support on 21 November 2010. Market sentiment continued to be negatively affected by uncertainty about the political situation and about the economic effect of the austerity measures introduced in the Irish Budget of 7 December 2010. As a result, in a statement dated 17 December 2010, the Group noted that any economic recovery in Ireland may take longer to achieve, that asset prices will remain depressed for longer than previously anticipated and therefore that the Group believed that the significant deterioration in the Irish market would affect the timing and level of value realisation from this portfolio.

At the year end, compared to 30 June 2010, given the deterioration in market conditions noted above, a further approximately 10 per cent of the £27bn Irish portfolio had become impaired, and the Group has therefore increased the level of provisions against the portfolio, increasing the impairment charge relating to Irish exposures for the full year 2010 to £4.3bn on a combined businesses basis. This has resulted in an increase in provisions as a percentage of impaired Irish loans to 53.7 per cent at the 2010 year end, in line with the Group's expectations in the statement of 17 December 2010.

In Australia, although economic performance has been robust overall, there are significant geographical and sector variations, and property assets situated outside the principal metropolitan areas have been particularly weak. The Group's exposure to these areas within the Australian portfolio drove increased impairments in 2010.

EXPOSURES SUBJECT TO THE INTERNAL RATINGS BASED APPROACH

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

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

SCOPE OF THE IRB PERMISSION

The Foundation IRB Approach is applied to wholesale portfolios. Foundation IRB models in respect of heritage Lloyds TSB portfolios are fully rolled out. Model roll out in respect of heritage HBOS portfolios has been partially completed with the majority of the models yet to roll out relating to Wholesale and Wealth and International portfolios. Retail IRB models in respect of the Group's retail portfolios are fully rolled out.

Portfolios whose associated models have yet to roll out, or where no model roll out is planned, are risk weighted under the Standardised Approach. The latter includes portfolios that are permanently exempted from the IRB approach, remaining subject to the Standardised Approach. A summary of Standardised RWAs as at 31 December 2010, by heritage and division is provided below.

Heritage	2010 Total Standardised RWA (£bn)	Of which			
		Wholesale	Retail	Wealth & International	Group Ops & Central Items
HBOS	106.3	53%	5%	35%	7%
LTSB	18.2	29%	2%	29%	40%

Heritage	2009 Total Standardised RWA (£bn)	Of which			
		Wholesale	Retail	Wealth & International	Group Ops & Central Items
HBOS	127.8	54%	6%	34%	6%
LTSB	17.7	41%	2%	25%	32%

The timing and intended regulatory approach for models yet to roll out is targeted for completion in 2013.

The Group target IRB environment is for a consistent calculation to be undertaken across the Group for identical exposure classes. As a consequence the Group intends to rationalise the different heritage model suites to deliver an efficient and accurate regulatory capital calculation. An integration plan to achieve this aim has been established and as a consequence this has moderated the pace of model roll out across the heritage HBOS wholesale portfolios. The revised model roll out plan has been agreed with the FSA. Adoption of the Advanced IRB Approach across all wholesale portfolios remains a long term objective of the Group.

Certain credit risk exposures categorised under the specialised lending and equity exposure classes are subject to alternative approaches that fall under the BIPRU provisions governing the IRB Approach. These include the Supervisory Slotting Approach for specialised lending exposures and the Simple Risk Weight Method for equity exposures.

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

INTERNAL DEVELOPMENT AND MONITORING OF IRB MODELS

Throughout 2010, models were governed and controlled by the Group Model Governance and Approvals Committee ('MGC'). Committee members comprised of the Chief Risk Officer, Group Finance Director, Group Analytics and Risk Modelling Director and a representative from each of the Divisional Risk teams. MGC is responsible for approving material models and for setting the governance framework and standards for all risk models across the Group. Material models are defined as those which contribute 3% or greater of the Group's credit RWA or where the portfolio exposure is more than £20bn.

In December 2010 the Board agreed that with effect from January 2011, the Retail, Wholesale and W&I Divisional Model Governance Committees ('DMGCs') would assume responsibility for the governance and control of each Division's models, including the approval of material models. The DMGCs comprise of the Group Executive Director responsible for the Division, the Divisional Risk Officer, together with representatives from Group Risk, Divisional Finance and Divisional Model Review Teams. The MGC will continue to set the governance framework and standards for all risk models across the Group and will continue to review and approve material non-Divisional (Group-wide) and Insurance models.

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

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

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

INTERNAL APPLICATION OF THE IRB APPROACH

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

Credit approval

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

Credit Limits

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

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

Pricing

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

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

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

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

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

Portfolio Reporting

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

INTERNAL RATING SCALES

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

PD Master Scales

Wholesale Master Scale

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

Retail Master Scale

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

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

A detailed analysis, by PD Grade, of credit risk exposures subject to the Foundation IRB and Retail IRB approaches is provided in the sections that follow. Analysis provided for credit risk exposures subject to the Advanced IRB Approach covers prior year comparatives only as no portfolios remained on the Advanced IRB Approach at year end.

ANALYSIS OF EXPOSURES SUBJECT TO THE ADVANCED IRB APPROACH

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

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

At year end no exposures remained subject to the Advanced IRB Approach.

Corporate Exposures

As at 31 December 2010, corporate exposures subject to the Advanced IRB Approach totalled £nil (2009: £54.3bn).

Corporate Main exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
1	-	-	-	-	-	-
2	-	-	-	-	-	-
3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	-	-	-	-	-	-

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
1	90	0.03%	50.81%	15.75%	31	30
2	1,069	0.03%	11.41%	6.62%	329	329
3	2,881	0.06%	18.06%	10.83%	615	615
4	1,364	0.18%	12.43%	17.90%	265	265
5	6,245	1.58%	52.03%	129.91%	2,234	2,135
6	13,625	6.73%	47.24%	189.05%	3,120	3,099
7	4,797	30.79%	55.16%	322.17%	924	899
Default	9,920	100.00%	59.38%	160.79%	733	704
Total	39,991	31.05%	47.71%	164.83%	8,251	8,076

Corporate SME exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
1	-	-	-	-	-	-
2	-	-	-	-	-	-
3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	-	-	-	-	-	-

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
1	21	0.03%	45.54%	10.30%	11	11
2	1	0.03%	71.22%	9.95%	1	1
3	68	0.06%	61.48%	13.79%	37	27
4	5	0.33%	54.21%	42.69%	1	1
5	2,763	1.80%	35.28%	76.71%	557	525
6	5,270	6.83%	36.12%	116.06%	781	752
7	1,347	30.04%	44.32%	225.36%	135	132
Default	4,869	100.00%	60.93%	158.87%	511	497
Total	14,344	39.62%	45.29%	132.60%	2,034	1,946

Central Government and Central Bank Exposures

As at 31 December 2010, central government and central bank exposures subject to the Advanced IRB Approach totalled £nil (2009: £1.1bn).

Central Governments and Central Banks exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
1	-	-	-	-	-	-
2	-	-	-	-	-	-
3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	-	-	-	-	-	-

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
1	634	0.01%	56.00%	10.21%	-	-
2	112	0.02%	56.00%	13.64%	-	-
3	306	0.03%	56.00%	16.95%	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	1,052	0.02%	56.00%	12.54%	-	-

Institution Exposures

As at 31 December 2010, institution exposures subject to the Advanced IRB Approach totalled £nil (2009: £21.0bn)

Institutions exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
1	-	-	-	-	-	-
2	-	-	-	-	-	-
3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	-	-	-	-	-	-

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
1	987	0.03%	23.11%	7.27%	-	-
2	2,666	0.03%	11.24%	6.58%	-	-
3	7,597	0.07%	48.44%	26.10%	41	41
4	8,929	0.35%	50.28%	42.63%	5	5
5	637	0.69%	48.73%	96.14%	-	-
6	90	7.19%	77.00%	278.49%	-	-
7	-	-	-	-	-	-
Default	109	100.00%	100.00%	100.00%	-	-
Total	21,015	0.75%	43.71%	33.35%	46	46

ANALYSIS OF EXPOSURES SUBJECT TO THE FOUNDATION IRB APPROACH

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

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

Following approval from the FSA, all Advanced IRB portfolios were transferred to the Foundation IRB Approach during 2010. Current year credit risk exposures, PDs and average risk weights are reflective of the impact of this transfer.

Corporate Exposures

As at 31 December 2010, corporate exposures subject to the Foundation IRB Approach totalled £144.3bn (2009: £101.8bn).

Corporate Main exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Average Risk Weight %	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Average Risk Weight %
1	2,876	0.03%	8.77%	4,760	0.03%	12.11%
2	4,579	0.03%	17.62%	1,355	0.03%	15.27%
3	20,271	0.04%	23.95%	17,419	0.04%	23.66%
4	30,390	0.25%	44.02%	30,382	0.26%	45.71%
5	20,595	1.50%	100.69%	20,822	1.38%	99.67%
6	14,707	8.60%	167.94%	4,657	6.02%	149.70%
7	4,062	31.58%	246.02%	865	43.50%	106.46%
Default	10,594	100.00%	-	2,930	100.00%	-
Total	108,074	12.53%	69.14%	83,190	4.76%	57.02%

Corporate SME exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Average Risk Weight %	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Average Risk Weight %
1	4	0.03%	32.71%	-	-	-
2	7	0.03%	20.01%	-	-	-
3	1,513	0.06%	31.84%	801	0.04%	28.54%
4	2,802	0.23%	46.91%	798	0.28%	48.46%
5	8,071	1.46%	86.51%	3,316	1.68%	86.22%
6	6,897	7.47%	127.07%	1,856	8.45%	130.92%
7	1,400	29.50%	195.84%	97	37.66%	194.12%
Default	6,834	100.00%	-	356	100.00%	5.89%
Total	27,528	28.65%	73.70%	7,224	8.41%	84.63%

Specialised Lending exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Average Risk Weight %	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Average Risk Weight %
1	-	-	-	-	-	-
2	-	-	-	-	-	-
3	226	0.06%	17.16%	275	0.06%	29.46%
4	2,904	0.29%	64.10%	3,578	0.30%	66.04%
5	3,992	1.39%	110.92%	6,613	1.48%	114.28%
6	709	5.35%	155.11%	569	7.54%	177.95%
7	-	-	-	-	-	-
Default	906	100.00%	-	327	100.00%	-
Total	8,737	11.54%	85.02%	11,362	4.21%	96.93%

Central Government and Central Bank Exposures

As at 31 December 2010, central government and central bank exposures subject to the Foundation IRB Approach totalled £22.9bn (2009: £14.3bn).

Central Governments and Central Banks exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Average Risk Weight %	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Average Risk Weight %
1	22,718	0.01%	5.54%	11,992	0.01%	6.13%
2	105	0.01%	8.87%	2,283	0.02%	5.84%
3	59	0.04%	13.10%	26	0.03%	15.68%
4	32	0.11%	21.17%	-	-	-
5	3	0.90%	74.87%	3	1.65%	94.20%
6	-	-	-	1	7.68%	177.77%
7	2	56.88%	201.96%	-	-	-
Default	1	100.00%	-	1	100.00%	-
Total	22,920	0.02%	5.63%	14,306	0.02%	6.13%

Institution Exposures

As at 31 December 2010, institution exposures subject to the Foundation IRB Approach totalled £23.9bn (2009: £19.7bn).

Institutions exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Average Risk Weight %	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Average Risk Weight %
1	-	-	-	24	0.03%	10.31%
2	317	0.03%	5.94%	3,044	0.03%	8.93%
3	16,922	0.04%	9.92%	14,426	0.04%	8.33%
4	5,898	0.20%	34.20%	1,881	0.19%	29.67%
5	586	1.36%	96.14%	144	1.67%	94.70%
6	77	3.41%	119.75%	5	11.32%	194.86%
7	-	-	-	-	-	-
Default	127	100.00%	-	161	100.00%	-
Total	23,927	0.65%	18.26%	19,685	0.89%	11.07%

ANALYSIS OF EXPOSURES SUBJECT TO THE RETAIL IRB APPROACH

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

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

As at 31 December 2010, retail exposures subject to the Retail IRB Approach totalled £435.3bn (£445.7bn).

Residential Mortgage exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD [1] %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) [2] £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
0	134,911	0.07%	9.79%	1.80%	2,089	894
1	107,385	0.29%	11.78%	6.57%	774	437
2	38,610	0.70%	13.42%	13.81%	525	234
3	15,281	0.99%	14.62%	19.18%	258	152
4	26,214	2.45%	14.40%	32.13%	135	78
5	15,429	3.55%	14.62%	40.01%	4,368	2,266
6	5,358	5.84%	21.09%	79.80%	26	17
7	3,601	11.67%	17.45%	84.47%	15	7
8	3,162	11.49%	18.41%	93.50%	45	37
9	2,725	16.95%	19.73%	112.90%	10	9
10	2,794	25.14%	18.53%	112.76%	8	6
11	2,301	38.39%	16.96%	100.48%	1	-
12	4,305	69.43%	16.68%	55.81%	4	-
Default	7,397	100.00%	18.08%	99.90%	8	-
Total	369,473	4.21%	12.20%	16.50%	8,266	4,137

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) [2] £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
0	137,598	0.06%	13.75%	2.24%	2,996	1,265
1	106,157	0.27%	17.59%	9.63%	798	217
2	43,400	0.68%	18.96%	19.83%	587	361
3	13,464	0.98%	16.19%	21.24%	40	10
4	25,754	1.67%	22.51%	41.52%	162	111
5	14,508	3.11%	18.39%	46.46%	4,731	2,140
6	8,087	6.02%	26.74%	102.10%	212	61
7	3,867	9.74%	25.22%	118.96%	9	6
8	2,656	11.68%	17.87%	91.18%	24	20
9	1,989	16.72%	17.86%	101.81%	11	10
10	2,052	24.59%	21.51%	131.31%	1	-
11	1,949	38.22%	18.54%	110.10%	3	2
12	2,942	66.72%	17.24%	65.47%	3	1
Default	7,614	100.00%	19.36%	145.61%	11	-
Total	372,037	3.77%	16.99%	20.79%	9,588	4,204

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

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

Key Movements

- The reduction in exposure weighted average LGDs and, subsequently, average risk weights has been driven by a recalibration of downturn LGD rates. This included the application of heritage HBOS Retail historic downturn data (generated over the course of the last two decades) to heritage Lloyds TSB Retail LGD models. In addition, new through-the-cycle ('TTC') methodologies have been adopted for mainstream mortgage portfolios.

Qualifying Revolving Retail Exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) [1] £m
0	5,174	0.06%	86.88%	3.53%	3,489	4,761
1	11,993	0.24%	74.95%	9.87%	19,293	10,175
2	4,431	0.54%	77.02%	19.31%	8,626	3,674
3	3,345	1.05%	72.92%	30.71%	3,555	2,106
4	3,222	1.88%	75.85%	49.03%	2,666	1,580
5	4,899	3.69%	68.17%	71.16%	2,249	2,138
6	1,258	6.06%	81.81%	118.59%	453	307
7	2,185	8.15%	65.82%	116.06%	584	655
8	1,454	11.97%	76.76%	167.71%	327	234
9	964	16.48%	65.40%	167.26%	145	185
10	1,617	26.48%	67.70%	182.35%	405	279
11	388	36.34%	70.57%	212.19%	33	31
12	425	64.37%	74.44%	184.71%	13	12
Default	1,694	100.00%	69.12%	225.33%	61	-
Total	43,049	8.03%	74.77%	57.53%	41,899	26,137

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) [1] £m
0	3,807	0.05%	78.90%	2.90%	2,380	3,375
1	11,760	0.23%	63.97%	7.93%	19,392	10,028
2	6,413	0.62%	64.34%	17.70%	9,411	5,196
3	2,402	0.98%	61.18%	24.46%	3,400	1,492
4	4,177	1.93%	63.55%	41.39%	3,138	2,199
5	3,801	3.76%	60.03%	62.85%	2,099	1,542
6	2,006	6.41%	66.43%	98.23%	792	497
7	1,699	7.93%	60.46%	105.45%	371	588
8	1,656	11.62%	59.62%	128.17%	461	317
9	971	15.90%	68.79%	173.51%	185	231
10	3,456	27.95%	59.82%	113.06%	1,606	1,119
11	544	34.64%	71.30%	182.87%	86	66
12	519	64.67%	69.57%	171.21%	16	15
Default	1,989	100.00%	55.63%	181.46%	65	1
Total	45,200	9.74%	64.15%	52.77%	43,402	26,666

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

Key Movements

- The increase in exposure weighted average LGDs was largely driven by a recalibration of credit card LGD models.

Other Retail exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
0	11	0.09%	85.02%	20.07%	-	-
1	618	0.31%	66.36%	36.09%	-	-
2	2,906	0.69%	57.77%	51.74%	17	3
3	562	1.00%	84.36%	90.53%	-	-
4	4,660	1.69%	61.77%	80.45%	17	4
5	3,214	3.22%	64.82%	96.75%	15	3
6	2,798	5.66%	65.47%	103.78%	12	2
7	906	9.05%	64.87%	111.96%	6	1
8	1,028	11.77%	62.00%	117.05%	1	-
9	202	17.33%	68.18%	151.20%	1	-
10	564	22.33%	67.35%	162.69%	14	6
11	490	35.05%	64.37%	168.70%	10	3
12	416	71.23%	69.54%	133.08%	-	-
Default	2,175	100.00%	64.35%	39.92%	-	-
Total	20,550	16.42%	63.81%	86.08%	93	22

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
0	16	0.09%	85.01%	19.92%	-	-
1	831	0.32%	60.98%	33.66%	-	-
2	3,059	0.68%	59.97%	53.06%	18	3
3	1,059	0.99%	76.28%	81.66%	-	-
4	6,452	1.71%	57.84%	75.60%	19	4
5	3,517	3.14%	60.23%	89.99%	16	3
6	3,526	5.35%	61.54%	97.38%	12	2
7	777	8.58%	63.07%	107.89%	6	1
8	1,274	11.52%	59.84%	112.60%	2	1
9	267	17.52%	68.63%	144.28%	10	4
10	662	22.40%	65.40%	153.19%	12	3
11	516	38.10%	59.31%	165.70%	1	-
12	629	74.01%	66.52%	118.28%	-	-
Default	2,704	100.00%	61.90%	46.03%	-	-
Total	25,289	16.68%	61.09%	82.11%	96	21

Key Movements

- The general increase in average risk weight percentage was largely driven by a recalibration of personal loans LGD models.

Retail SME exposures by PD Grade

PD Grade	2010 Credit Risk Exposure £m	2010 Exposure Weighted Average PD %	2010 Exposure Weighted Average LGD %	2010 Average Risk Weight %	2010 Undrawn Commitments (Gross) £m	2010 Undrawn Commitments (Post Credit Conversion Factor) £m
0	-	-	-	-	-	-
1	-	-	-	-	-	-
2	408	0.60%	64.87%	50.85%	357	337
3	280	1.12%	73.25%	75.79%	189	184
4	191	1.67%	77.38%	92.86%	113	111
5	489	2.62%	60.62%	85.89%	159	160
6	105	5.67%	80.21%	118.94%	37	38
7	35	8.04%	110.27%	165.04%	15	14
8	230	10.61%	89.48%	152.61%	83	90
9	65	18.01%	97.27%	209.99%	18	21
10	-	-	-	-	-	-
11	81	34.09%	108.83%	289.93%	19	21
12	18	78.17%	123.70%	194.01%	6	7
Default	347	100.00%	4.63%	31.84%	2	-
Total	2,249	20.24%	63.70%	91.97%	998	983

PD Grade	2009 Credit Risk Exposure £m	2009 Exposure Weighted Average PD %	2009 Exposure Weighted Average LGD %	2009 Average Risk Weight %	2009 Undrawn Commitments (Gross) £m	2009 Undrawn Commitments (Post Credit Conversion Factor) £m
0	-	-	-	-	-	-
1	1	0.26%	16.44%	8.45%	-	-
2	981	0.62%	56.92%	80.14%	797	766
3	9	1.13%	10.21%	11.38%	-	-
4	549	1.55%	57.45%	72.11%	182	184
5	279	2.84%	53.86%	77.57%	59	62
6	425	5.89%	38.26%	60.62%	38	40
7	105	8.18%	50.11%	83.98%	13	11
8	211	10.63%	61.69%	111.66%	37	43
9	169	18.67%	68.05%	155.96%	21	25
10	1	24.85%	28.37%	70.69%	-	-
11	49	35.92%	67.25%	187.69%	3	4
12	56	77.81%	70.87%	119.55%	8	9
Default	318	100.00%	9.44%	37.10%	4	-
Total	3,153	15.53%	50.38%	79.99%	1,162	1,144

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

Specialised lending exposures subject to supervisory slotting

Specialised lending exposures subject to supervisory slotting (being predominantly property investment and property development transactions) are assigned to a grade, the determination of which takes into account the following factors:

- financial strength e.g. market conditions, financial ratios, stress analysis, financial structure, cash flow predictability, market liquidity and degree of over-collateralisation of trade;

- political and legal environment e.g. political risks, country risks, force majeure risks, government support, stability of legal and regulatory environment, enforceability of contracts and collateral and security;

- transaction and / or asset characteristics e.g. location, design and technology risks, construction risks, completion guarantees, financial strength of contractors and reliability, operating risks, off-take risks, supply risks, financing terms, resale values, value sensitivities and susceptibility to damage;

- strength of the sponsor and developer including any public private partnership income stream e.g. sponsor's financial strength, quality of financial disclosure, sponsor's support, reputation and track record, trading controls and hedging policies; and

- security package e.g. assignment of contracts and accounts, pledge of assets, lender's control over cash flow, covenant package, reserve funds, nature of lien, quality of insurance coverage, asset control and inspection rights.

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

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

As at 31 December 2010, total credit risk exposures in respect of specialised lending subject to supervisory slotting criteria amounted to £12.5bn (2009: £12.2bn). Risk weighted assets arising from this amounted to £6.4bn (2009: £7.8bn) as analysed in the table below.

Grade	Remaining Maturity <2.5 years		Remaining Maturity >2.5 years	
	2010 Exposure £m	2010 Risk Weighted Assets £m	2010 Exposure £m	2010 Risk Weighted Assets £m
1) Strong	208	104	2,316	1,512
2) Good	443	325	2,232	1,938
3) Satisfactory	755	865	464	534
4) Weak	307	767	141	352
5) Default [1]	5,233	-	440	-
Total	6,946	2,061	5,593	4,336

Grade	Remaining Maturity <2.5 years		Remaining Maturity >2.5 years	
	2009 Exposure £m	2009 Risk Weighted Assets £m	2009 Exposure £m	2009 Risk Weighted Assets £m
1) Strong	88	44	2,642	1,728
2) Good	381	268	989	891
3) Satisfactory	1,058	1,217	429	494
4) Weak	914	2,284	362	906
5) Default [1]	4,415	-	894	-
Total	6,856	3,813	5,316	4,019

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

Key Movements

- The increase in defaulted exposures with a remaining maturity of less than two and half years is a result of further downgrades within the Irish property development portfolios, following the deterioration in economic conditions within Ireland.

Equity exposures subject to the Simple Risk Weight Method

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

As at 31 December 2010, total credit risk exposures in respect of equities subject to the Simple Risk Weight Method amounted to £2.3bn (2009: £2.1bn). Risk weighted assets arising from this also amounted to £5.5bn (2009: £5.3bn).

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

	2010 Credit Risk Exposure £m	2010 Risk Weighted Asset £m	2009 Credit Risk Exposure £m	2009 Risk Weighted Asset £m
Privately traded equity exposures – 190% [1]	1,693	3,217	1,334	2,534
Publicly traded equity exposures – 290%	62	179	149	432
Other equity exposures – 370%	576	2,133	632	2,338
Total	2,331	5,529	2,115	5,304

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

Further information on equity exposures is provided on pages 73 to 74.

COMPARISON OF EXPECTED LOSSES TO ACCOUNTING IMPAIRMENT LOSSES

The table below provides a comparison of gross expected losses as at 31 December 2009 to the net charge to the income statement (impairment losses) for the year to 31 December 2010, in respect of credit risk exposures subject to the IRB Approach. Expected losses in relation to the Group's IRB portfolios are derived from the underlying IRB models, being a function of the associated PD, LGD and EAD estimates, and represent the potential loss on a portfolio over a 12 month period. Where expected losses on a portfolio exceed the impairment provisions raised against the portfolio, the 'excess' is deducted from capital, split equally between tier 1 and tier 2 capital.

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

- Accounting impairment losses seek to measure loss on the basis of the economic conditions at the balance sheet date. However expected loss calculations are predicated on loss estimates that are based on economic downturn conditions.
- Expected loss calculations forecast potential losses arising from accounts that currently exhibit no indication of impairment. However accounting impairment losses specifically exclude any customers that are currently operating within the terms of the credit agreement.
- Expected losses in relation to portfolios that are based on through-the-cycle ('TTC') PD estimates utilise historic default experience, whereas accounting impairment losses are based on the loss incurred at a point-in-time ('PIT').
- Expected loss calculations anticipate additional drawings made by customers who are yet to default (EAD estimate). Accounting impairment losses reflect exposures value and conditions at the balance sheet date.

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

	Expected losses as at 31 December 2009 £m	Impairment losses for the year to 31 December 2010 [1] £m	Expected losses as at 31 December 2008 [2] £m	Impairment losses for the year to 31 December 2009 [1] £m
Advanced and Foundation IRB Approaches				
Corporate (Main, SME and Specialised lending)	10,244	2,209	5,245	6,911
Central governments and central banks	1	-	2	-
Institutions	115	87	228	-
Retail IRB Approach				
Retail - Residential mortgages	2,020	549	1,853	924
Retail - Qualifying revolving retail exposures	2,026	1,531	3,093	1,999
Retail - Other retail	2,376	1,178	2,707	2,005
Retail - SME	137	-	120	-
Other IRB Approaches				
Corporate - Specialised lending [3]	2,684	1,958	783	1,947
Equities	27	-	39	-
Total	19,630	7,512	14,070	13,786
Impairment losses on standardised portfolios		5,433		8,521
Fair value and other adjustments		(2,231)		(6,527)
Net charge to the income statement (Loans and advances to customers and banks)		10,714		15,780

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

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

[3] For corporate specialised lending portfolios subject to the supervisory slotting approach, exposures categorised as 'default' do not attract a risk weighting but are instead treated as expected loss deductions at a rate of 50% of the exposure value.

Key Movements

- Factors leading to the reduction in impairment losses during 2010 are explained on pages 48 to 49. Expected losses derived at the end of 2009 were reflective of the downturn economic parameters used at the time.

Accounting policies in relation to the impairment of loans and receivables and factors impacting loss experience during the year to 31 December 2010 are provided within the Past Due Exposures, Impaired Exposures and Impairment Provisions section of the document.

MODEL PERFORMANCE

This section provides an analysis of the performance of IRB models over 2010.

The table below compares the estimated and actual Probability of Default ('PD') and Loss Given Default ('LGD'), and Exposure at Default ('EAD') ratio by exposure class. The values are taken from the Group's regulatory capital calculation models, including regulatory floors. For the purposes of comparison, EAD weighting has been used throughout.

Validation of model parameters and outputs forms part of the control framework surrounding the development and monitoring of Retail IRB and Foundation IRB models described on pages 50 to 51.

IRB Exposure Class	Probability of Default		Loss Given Default of Defaulted Assets		EAD of Defaulted Assets
	Estimated Dec 09 %	Actual Dec 10 %	Estimated Dec 09 %	Actual Dec 10 %	Ratio of Predicted to Actual %
Wholesale Business					
Central governments and central banks	0.02%	0.00%			
Institutions	0.18%	0.00%			
Corporates	3.22%	4.68%			
Retail Business					
Residential mortgages	1.77%	1.33%	18.78%	7.09%	1.02
Qualifying revolving retail exposures	5.58%	4.69%	65.25%	68.70%	1.19
Other retail	6.28%	6.78%	60.18%	69.80%	2.10
Retail SME	6.16%	4.70%	65.00%	71.00%	0.47

Each exposure class consists of a number of IRB models. The PD models are primarily through-the-cycle calibrated or hybrid models, and as a result, are designed to predict the long term average PD for each portfolio, which should remain broadly stable over an economic cycle. Actual performance will be reflective of the current position within the economic cycle.

The LGD models are downturn calibrated. Determination of actual LGD also includes the use of downturn calibrated model estimates for those assets where losses are not yet realised. The impact of annual model updates also therefore contributes to the difference between estimated and actual LGD.

The EAD ratio is provided as a proxy for the regulatory requirement to disclosure information about Credit Conversion Factors. The ratio is provided as it allows a consistent measurement to be produced across all parts of the Group, and the Group believes this to be a more useful measure. Where the predicted EAD was greater than the actual exposure on the date of default, the ratio will be greater than 1.

No LGD or EAD information is provided for central governments and central banks, institutions or corporates, as these parameters are not modelled under the Foundation IRB Approach.

EXPOSURES SUBJECT TO THE STANDARDISED APPROACH

As at 31 December 2010, credit risk exposures risk weighted under the Standardised Approach amounted to £180.7bn (2009: £195.3bn), generating risk weighted assets of £124.5bn (2009: £145.5bn) and a capital requirement of £10.0bn (2009: £11.6bn).

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

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

Key movements in Standardised exposures are explained on p.33.

Central Governments and Central Banks

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	40,110	-	40,110	-
100%	53	-	53	53
150%	5	-	5	7
Total	**40,168**	**-**	**40,168**	**60**

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	35,275	-	35,275	-
100%	68	-	68	68
150%	10	-	10	15
Total	35,353	-	35,353	83

Regional Governments and Local Authorities

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
20%	64	-	64	13
100%	1	-	1	1
Total	**65**	**-**	**65**	**14**

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
20%	71	-	71	14
100%	11	-	11	11
Total	82	-	82	25

Administrative Bodies and Non-Commercial Undertakings

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
20%	66	-	66	13
100%	281	-	281	281
Total	347	-	347	294

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
20%	63	-	63	13
100%	310	-	310	310
Total	373	-	373	323

Institutions

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	76	-	76	-
20%	480	-	480	96
50%	154	(1)	153	77
100%	106	-	106	106
150%	9	-	9	13
Total	825	(1)	824	292

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	44	-	44	-
20%	392	-	392	79
50%	144	-	144	72
100%	82	-	82	82
150%	6	-	6	9
Total	668	-	668	242

Corporates

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	2,999	-	2,999	-
20%	201	-	201	40
50%	68	-	68	34
100%	41,086	(243)	40,843	40,843
150%	32	-	32	48
Total	**44,386**	**(243)**	**44,143**	**40,965**

Exposures to corporates amounting to £1,610m (2009: £932m) are covered by eligible financial collateral, allowing a risk weight of 0% to be applied. This collateral has not been used to reduce the exposures recognised for risk weighting purposes.

Exposures to corporates amounting to £183m (2009: £171m) are covered by an export credits guarantee from the UK Export Credit Agency. A risk weight of 0% has been applied to these exposures.

Exposures to corporates amounting to £112m (2009: £nil) are covered by credit derivatives, allowing a risk weight of 20% to be applied.

A further £8m (2009: £39m) of exposures to corporates are covered by guarantees that allow a reduced risk weight to be applied.

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	2,165	-	2,165	-
20%	1,136	-	1,136	227
50%	14	-	14	7
100%	52,531	(232)	52,299	52,299
150%	134	-	134	201
Total	55,980	(232)	55,748	52,734

Retail

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	18	-	18	-
20%	8	-	8	2
75%	9,476	(75)	9,401	7,052
100%	593	(99)	494	494
150%	8	-	8	12
Total	**10,103**	**(174)**	**9,929**	**7,560**

Retail exposures amounting to £nil (2009: £93m) are covered by guarantees that allow a reduced risk weight to be applied.

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	1	-	1	-
20%	88	-	88	17
75%	7,418	(80)	7,338	5,503
100%	3,090	(84)	3,006	3,006
150%	7	-	7	10
Total	10,604	(164)	10,440	8,536

Secured on Real Estate Property

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	558	-	558	-
20%	5	-	5	1
35%	9,971	-	9,971	3,490
50%	1,678	-	1,678	839
75%	2,832	-	2,832	2,124
100%	25,297	(46)	25,251	25,251
150%	2,584	-	2,584	3,877
Total	**42,925**	**(46)**	**42,879**	**35,582**

Exposures secured on real estate property amounting to £500m (2009: £391m) are covered by a guarantee provided through a Dutch Government scheme. A risk weight of 0% has been applied to these exposures.

Exposures secured on real estate property amounting to £5m (2009: £3m) are subject to an insurance arrangement which allows the application of a lower risk weighting of 20%.

A further £nil (2009: £2m) of exposures secured on real estate property are covered by eligible financial collateral, allowing a reduced risk weight to be applied. This collateral has not been used to reduce the exposures recognised for risk weighting purposes.

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	391	-	391	-
20%	3	-	3	1
35%	10,229	-	10,229	3,580
50%	1,666	-	1,666	833
75%	3,272	-	3,272	2,455
100%	29,914	(52)	29,862	29,862
150%	1,773	-	1,773	2,660
Total	47,248	(52)	47,196	39,391

Past Due Items

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	23	-	23	-
20%	2	-	2	1
35%	-	-	-	-
50%	36	(1)	35	17
75%	194	-	194	145
100%	6,911	-	6,911	6,911
150%	5,475	-	5,475	8,212
Total	**12,641**	**(1)**	**12,640**	**15,286**

Past due items amounting to £1m (2009: £3m) are subject to an insurance arrangement which allows the application of a lower risk weighting of 20%.

A further £1m (2009: £53m) of past due items are covered by guarantees that allow a reduced risk weight to be applied.

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	11	-	11	-
20%	54	-	54	11
35%	166	-	166	58
50%	18	-	18	9
75%	306	-	306	230
100%	6,934	-	6,934	6,934
150%	4,629	-	4,629	6,944
Total	12,118	-	12,118	14,186

Items Belonging to Regulatory High Risk Categories

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
100%	39	-	39	39
150%	131	-	131	197
370%	-	-	-	-
Deduction from capital	-	-	-	-
Total	170	-	170	236

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
100%	2	-	2	2
150%	126	-	126	189
370%	1,048	-	1,048	3,878
Deduction from capital	21	-	21	-
Total	1,197	-	1,197	4,069

Short Term Claims on Institutions or Corporates

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
50%	154	-	154	77
100%	747	-	747	747
Total	901	-	901	824

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
50%	-	-	-	-
100%	632	-	632	632
Total	632	-	632	632

Other Items

Risk Weight	2010 Credit Risk Exposure (Pre CRM) £m	2010 Credit Risk Mitigation £m	2010 Credit Risk Exposure (Post CRM) £m	2010 Risk Weighted Asset £m
0%	3,438	-	3,438	-
20%	1,683	-	1,683	337
50%	65	-	65	33
75%	108	-	108	81
100%	22,900	-	22,900	22,900
Total	28,194	-	28,194	23,351

Risk Weight	2009 Credit Risk Exposure (Pre CRM) £m	2009 Credit Risk Mitigation £m	2009 Credit Risk Exposure (Post CRM) £m	2009 Risk Weighted Asset £m
0%	3,827	-	3,827	-
20%	2,103	-	2,103	421
50%	186	-	186	93
75%	-	-	-	-
100%	24,664	-	24,664	24,664
Total	30,780	-	30,780	25,178

Further details on securitisation positions subject to the Standardised Approach can be found within the Securitisations section of the document.

NON-TRADING BOOK EXPOSURES IN EQUITIES

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

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

The accounting techniques and valuation methodologies applied are set out within the Group's accounting policies, an extract of which is provided below for reference.

Available-for-sale financial assets

Debt securities and equity shares that are not classified as trading securities, at fair value through profit or loss, held-to maturity investments 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 a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. Reclassification of a financial asset from the available-for-sale category to the held-to-maturity category is permitted when the Group has the ability and intent to hold that financial asset to maturity.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable. Effective interest rates for financial assets reclassified to the loans and receivables and held-to maturity categories are determined at the reclassification date. Any previous gain or loss on a transferred asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest method or until the asset becomes impaired. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest method.

When an impairment loss is recognised in respect of available-for-sale assets transferred, the unamortised balance of any available-for-sale reserve that remains in equity is transferred to the income statement and recorded as part of the impairment loss.

Equity investments (including venture capital)

Unlisted equities and fund investments are accounted for as trading and other financial assets at fair value through profit or loss or as available-for-sale financial assets. These investments are valued using different techniques as a result of the variety of investments across the portfolio in accordance with the Group's valuation policy and are calculated using International Private Equity and Venture Capital Guidelines.

Depending on the business sector and the circumstances of the investment, unlisted equity valuations are based on earnings multiples, net asset values or discounted cash flows.

– 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.

– Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple.

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

Accounting policies in relation to the recognition of impairment losses on available-for-sale financial assets are set out on pages 42 to 43.

The balance sheet value of non-trading book exposures in equities, as at 31 December 2010, is presented in the table below. There was no difference between the balance sheet value and the fair value of these exposures.

Equity Grouping	2010 Balance Sheet Value £m	2009 Balance Sheet Value £m
Publicly quoted equities	67	149
Privately held equities	2,404	2,417
Total	2,471	2,566

Realised gains recognised in the year to 31 December 2010 in respect of the sale and liquidation of non-trading book exposures in equities amounted to £356m (2009: £99m).

As at 31 December 2010, net unrealised gains on available-for-sale equities amounted to £462m (2009: £221m). This gain has been included within tier 2 capital.

SECURITISATIONS

The Group is an active participant in the securitisation market, operating as an originator and sponsor to its own securitisations and an investor in third party securitisations. The Group also provides liquidity facilities to both own originated and sponsored securitisations as well as to third parties.

Securitisation strategy and roles

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

As an originator, the Group makes use of securitisation as a means of actively managing its balance sheet. Origination activities mainly extend around the Group's retail and commercial lending portfolios where the primary objective is funding, although certain synthetic commercial loan securitisations, involving the use of credit default swaps, are used for capital efficiency purposes. Further details on the Group's originated securitisations are provided on p.77.

Through its sponsoring activities, the Group has established four asset backed commercial paper conduits which it manages and supports, where relevant, through the provision of liquidity facilities. The purpose of each of the conduits is explained more fully on p.80.

As an investor, the Group invests directly in third party asset backed securities and provides liquidity facilities to other third party securitisations, further details of which are provided on p.80.

Summary analysis

As at 31 December 2010, credit risk exposures classed as securitisation positions amounted to £56.4bn (2009: £69.1bn). An analysis of these exposures by type and risk weight approach, together with the associated capital requirement, is provided in the table below. In addition, the table provides an analysis of further securitisation positions which have been deducted from capital.

Securitisation type and risk weight approach	2010 Credit risk exposure [1] £m	2010 Risk weighted assets [2] £m	2010 Capital requirement £m	2010 Deduction from capital £m
Originated:				
Ratings Based Approach	9,256	1,891	151	123
Standardised Approach	8	28	2	10
Supervisory Formula Approach	106	8	1	18
	9,370	1,927	154	151
Sponsored and Invested:				
Internal Assessment Approach	9,296	767	61	-
Ratings Based Approach	37,734	6,288	503	286
Standardised Approach	-	-	-	-
	47,030	7,055	564	286
TOTAL	56,400	8,982	718	437

Securitisation type and risk weight approach	2009 Credit risk exposure [1] £m	2009 Risk weighted assets [2] £m	2009 Capital Requirement £m	2009 Deduction from capital £m
Originated:				
Ratings Based Approach	6,335	851	68	164
Standardised Approach	8	27	2	10
Supervisory Formula Approach	-	-	-	18
	6,343	878	70	192
Sponsored and Invested:				
Internal Assessment Approach	12,477	2,158	173	7
Ratings Based Approach	50,070	4,819	385	439
Standardised Approach	222	60	5	-
	62,769	7,037	563	446
TOTAL	69,112	7,915	633	638

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

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

ORIGINATED SECURITISATIONS

Summary of accounting policies

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

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

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

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

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

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

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

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

The Group's securitised residential mortgage assets are not derecognised because the Group retains substantially all the risks and rewards associated with the underlying portfolios of assets. In addition securitised commercial banking loans are not derecognised because the Group has not transferred the contractual rights to receive the cash flows from those loans nor has it assumed a contractual obligation to pay the cash flows from those loans to a third party.

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

Purchased and retained securitisation positions are valued in accordance with the methodologies outlined on pages 243 to 249 (Fair Values of Financial Assets and Liabilities) of the Lloyds Banking Group plc Annual Report and Accounts 2010.

Regulatory treatment

In deriving credit risk exposures associated with originated securitisations, the Group takes into account that certain securitised assets, whilst held on the balance sheet for accounting purposes, are deemed to have met the prudential significant risk transfer tests when securitised and therefore the retained positions in the securitisations are included within regulatory calculations rather than the underlying assets. Where the minimum requirements for recognition of significant risk transfer are not met, the underlying assets remain part of the relevant exposure class and are risk weighted accordingly. This mainly applies in the case of funding transactions.

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

Securitisation programmes and activity during the year

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

Securitisation Programmes [1]	2010 Gross assets securitised £m	2009 Gross assets securitised £m	Movement £m	2009 Notes in issue £m	2009 Notes in issue £m	Movement £m
UK residential mortgages	146,200	152,443	(6,243)	114,428	129,698	(15,270)
Commercial loans	11,860	13,071	(1,211)	8,936	8,266	670
Irish residential mortgages	6,007	6,522	(515)	6,191	6,585	(394)
Credit card receivables	7,327	5,155	2,172	3,856	2,699	1,157
Dutch residential mortgages	4,526	4,800	(274)	4,316	4,663	(347)
Personal loans	3,012	3,730	(718)	2,011	2,613	(602)
PFI / PPP and project finance loans	776	877	(101)	110	45	65
Corporate loans and revolving credit facilities	-	595	(595)	-	7	(7)
Motor vehicle loans	926	443	483	975	470	505
	180,634	187,636	(7,002)	140,823	155,046	(14,223)
Less notes held by the Group				(100,081)	(117,489)	17,408
Total				40,742	37,557	3,185

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

Gross assets securitised decreased by £7.0bn during the year, primarily as a result of amortisation of the pools within the residential mortgage and personal loans programmes, the closure of a commercial loans programme and maturities within the remaining commercial loans programmes. The increase in gross assets securitised in relation to credit card receivables of £2.2bn reflects the inclusion of further assets originated from the Group's balance sheet during the year.

There were no realised gains or losses on the disposal of assets attributed to programme closures during the year.

Gross securitised exposure

On a regulatory basis, the gross securitised exposures in relation to originated securitisations where significant risk transfer has been achieved amounted to £15.2bn (2009: £10.1bn) comprising both traditional and synthetic originated securitisations. An analysis is provided in the table below together with the amount of impaired exposures, past due but not impaired exposures and value adjustments.

	Gross Securitised Exposure				
	2010 Traditional £m	2010 Synthetic £m	2010 Impaired exposures £m	2010 Past due but not impaired exposures £m	2010 Value adjustments [1] £m
Dutch residential mortgages	2,139	-	16	77	-
Commercial, PFI / PPP and project finance loans	444	5,056	93	43	-
Asset backed securities	7,597	-	-	-	2,569
Total	10,180	5,056	109	120	2,569

[1] Value adjustments applied to asset backed securities refer to impairment writedowns and other fair value adjustments netted against the gross nominal positions of the securities. At year end, £2,295m of the value adjustments applied against positions rated below BB- or that were unrated.

The net charge to the income statement for the year to 31 December 2010 in respect of losses attributed to the gross securitised exposures noted above amounted to £32m.

	Gross Securitised Exposure				
	2009 Traditional £m	2009 Synthetic £m	2009 Impaired exposures £m	2009 Past due but not impaired exposures £m	2009 Value adjustments [1] £m
Dutch residential mortgages	2,406	-	16	72	-
Commercial, PFI / PPP and project finance loans	423	7,318	131	95	-
Asset backed securities	-	-	-	-	-
Total	2,829	7,318	147	167	-

Originated securitisations subject to the Ratings Based Approach

The Ratings Based Approach utilises a set of defined risk weights prescribed by the FSA. The appropriate risk weighting is dependent on factors such as maturity and seniority of the position together with the granularity of the asset pool backing the position. As at 31 December 2010, originated securitisation positions risk weighted under the Ratings Based Approach amounted to £11.7bn (2009: £6.5bn), generating a capital requirement of £151m (2009: £68m).

Senior Positions

S&P Equivalent Rating and RBA Risk Weight	2010 Exposure £m	2009 Exposure £m
Super Senior Positions: 6%	-	3,199
AAA: 7%	3,785	-
AA: 8%	2,069	2,518
BB: 425%	2	-
Total	5,856	5,717

Non-Senior Positions

S&P Equivalent Rating and RBA Risk Weight	2010 Exposure £m	2009 Exposure £m
AAA: 12%	62	196
AA: 15%	1,039	181
A+: 18%	306	55
A: 20%	238	-
A-: 35%	229	94
BBB+: 50%	228	-
BBB: 75%	310	57
BBB-: 100%	229	12
BB+: 250%	264	14
BB: 425%	236	9
BB-: 650%	259	-
Below BB- / Unrated: Deduction	1,907	164
Total	5,307	782

Tranches Backed by Non-Granular Pools

S&P Equivalent Rating and RBA Risk Weight	2010 Exposure £m	2009 Exposure £m
Below BB- / Unrated: Deduction	511	-
Total	511	-

TOTAL

S&P Equivalent Rating	2010 Exposure £m	2009 Exposure £m
Super Senior Positions	-	3,199
AAA	3,847	196
AA	3,108	2,699
A+	306	55
A	238	-
A-	229	94
BBB+	228	-
BBB	310	57
BBB-	229	12
BB+	264	14
BB	238	9
BB-	259	-
Below BB- / Unrated: Deduction	2,418	164
Total [1]	11,674	6,499
Value adjustments taken to reserves	(2,295)	-
Deduction from capital	(123)	(164)
Total Credit Risk Exposure	9,256	6,335

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

Originated securitisations subject to the Standardised Approach

At 31 December 2010, credit risk exposures associated with originated securitisation positions amounting to £8m (2009: £8m) were risk weighted under the Standardised Approach to credit risk, generating an RWA of £28m (2009: £27m) and a capital requirement of £2m (2009: £2m).

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

Risk Weight %	2010 Credit risk exposure £m	2010 Risk weighted assets £m	2010 Capital requirement £m	2010 Deduction from capital £m
350%	8	28	2	-
Deduction	-	-	-	10
Total	**8**	**28**	**2**	**10**

For the Candide 1 and 2 securitisation programmes, risk weight bands based on the use of an ECAI (Moody's) have been applied, resulting in a risk weight of 350% applied to £8m (2009: £8m) of the retained position, with a further £10m (2009: £10m) categorised as '350% and below or unrated' and therefore deducted from capital.

Risk Weight %	2009 Credit risk exposure £m	2009 Risk weighted assets £m	2009 Capital requirement £m	2009 Deduction from capital £m
350%	8	27	2	-
Deduction	-	-	-	10
Total	8	27	2	10

Originated securitisations subject to the Supervisory Formula Approach

At 31 December 2010, aggregate retained positions in relation to securitisation programmes amounting to £106m (2009: nil) were risk weighted under the Supervisory Formula Approach, generating an RWA of £8m (2009: nil). In addition aggregate retained positions relating to reserve accounts of £18m (2009: £18m) were deducted from capital.

SPONSORED AND INVESTED SECURITISATIONS

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

Through Cancara, the Group provides financing facilities to the Group's core corporate and financial institution clients, funded by asset backed commercial paper.

Argento was established during 2010 in order to provide an additional source of funding for the Group through the issuance of asset backed commercial paper, backed by existing Group assets (primarily asset backed securities and corporate and other debt securities).

Grampian funds a diverse portfolio of asset backed securities through the issue of asset backed commercial paper. It represents an incremental funding source for the Group.

Landale was originally established for investment purposes to fund both client assets and own debt origination. As a result of adverse funding conditions, the Group decided to wind down the programme during 2010. No asset backed commercial paper was in issuance at year end.

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

	2010 Cancara £m	2010 Argento £m	2010 Grampian £m	2010 Landale £m	2010 TOTAL £m
Loans and advances	3,957	-	-	-	3,957
Debt securities classified as loans and receivables:					
Asset backed securities	-	1,448	6,957	-	8,405
Corporate and other debt securities	-	202	-	-	202
Debt securities classified as available-for-sale financial assets:					
Asset backed securities	2,587	1,436	-	-	4,023
Corporate and other debt securities	-	463	-	-	463
Total assets	6,544	3,549	6,957	-	17,050

	2009 Cancara £m	2009 Argento £m	2009 Grampian £m	2009 Landale £m	2009 TOTAL £m
Loans and advances	3,681	-	-	-	3,681
Debt securities classified as loans and receivables	15	-	9,867	698	10,580
Debt securities classified as available-for-sale financial assets:					
Asset backed securities	5,382	-	-	-	5,382
Total assets	9,078	-	9,867	698	19,643

Total assets decreased by £2.6bn during the year as a result of reductions in the underlying asset backed securities portfolios of Cancara and Grampian, primarily reflecting portfolio amortisation and maturities, and the wind down of Landale, net of additional assets introduced through the establishment of Argento.

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

The majority of these investments are accounted for as loans and receivables on the balance sheet and held at amortised cost, with the remainder held as available-for-sale or at fair value through the income statement. At year end the Group's net exposure to direct investments in asset backed securities amounted to £22.3bn (2009: £27.6bn), further details on which are presented on p.260 of the 2010 Lloyds Banking Group plc Annual Report and Accounts. The reduction during the year of £5.3bn reflects a combination of disposal of positions and non-replenishment of total holdings after amortisations or maturities.

For Cancara, the Group has approval to utilise the Internal Assessment Approach for calculating capital requirements on the basis of the liquidity facilities provided to the conduit. As at 31 December 2010, the total credit risk exposure of the Group in respect of the liquidity facilities provided to Cancara amounted to £9.3bn (2009: £12.5bn). An analysis of this exposure, by underlying exposure type, is provided in the table below.

Exposure Type	2010 Exposure £m	2009 Exposure £m
Mortgage Backed Securities:		
US RMBS	-	37
Non-US RMBS	3,425	3,402
CMBS	584	1,380
Collateralised Debt Obligations:		
CLO	154	1,354
Personal Sector:		
Auto Loans	1,063	1,597
Credit Cards	421	480
FFELP Student Loans	-	223
Trade receivables	1,751	1,739
Other ABS	1,898	2,272
Total [1]	9,296	12,484
Deduction from capital	-	(7)
Total Credit Risk Exposure	9,296	12,477

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

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

S&P Equivalent Rating and IAA Risk Weight	2010 Exposure £m	2009 Exposure £m
AAA: 7%	5,641	4,013
AA: 8%	1,766	4,718
A+: 10%	1,424	910
A: 12%	367	583
A-: 20%	98	786
BBB: 60%	-	893
BBB-: 100%	-	574
Below BB- / Unrated: Deduction	-	7
Total	9,296	12,484
Deduction from capital	-	(7)
Total Credit Risk Exposure	9,296	12,477

For Argento, Grampian and the majority of Landale, capital requirements are determined by looking through to the underlying asset portfolios of the conduits and not therefore in respect of the liquidity facilities provided. As a result of this approach, risk positions attached to the underlying asset portfolios are treated in a similar way to risk positions arising from invested securitisation activities, with capital requirements calculated under the Ratings Based Approach. As at 31 December 2010, the total credit risk exposure arising in respect of the risk positions attached to the underlying asset portfolios of these conduits amounted to £15.3bn (2009: £11.2bn).

The total credit risk exposure relating to direct investments in third party asset backed securities amounted to £22.4bn (2009: £38.8bn).

An analysis of sponsored and invested securitisation positions subject to the Ratings Based Approach, by exposure type, is provided in the table below.

Exposure Type	**2010 Exposure £m**	2009 Exposure £m
Mortgage Backed Securities:		
US RMBS	**530**	8,929
Non-US RMBS	**5,738**	9,031
CMBS	**7,503**	6,527
Collateralised Debt Obligations:		
CLO	**6,283**	7,294
Other	**951**	2,323
Personal Sector:		
Auto Loans	**874**	1,732
Credit Cards	**2,210**	3,740
Personal Loans	**266**	860
FFELP Student Loans	**8,728**	10,308
Other ABS	**5,429**	3,566
Total [1]	**38,512**	54,310
Value adjustments taken to reserves	**(492)**	(3,801)
Deduction from capital	**(286)**	(439)
Total Credit Risk Exposure [2]	**37,734**	50,070

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

[2] The total credit risk exposure comprises £22,420m (2009: £38,822m) in relation to direct investments in third party asset backed securities and £15,314m (2009: £11,248m) in relation to the underlying asset portfolios of Argento, Grampian and Landale.

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

Senior Positions

S&P Equivalent Rating and RBA Risk Weight	2010 Exposure £m	2009 Exposure £m
Super Senior Positions: 6%	-	82
AAA: 7%	20,482	32,804
AA: 8%	5,559	2,918
A+: 10%	1,555	611
A: 12%	724	934
A-: 20%	372	565
BBB+: 35%	547	394
BBB: 60%	357	128
BBB-: 100%	353	133
BB+: 250%	352	465
BB: 425%	81	147
BB-: 650%	206	-
Below BB- Unrated: Deduction	409	1,463
Total	30,997	40,644

Non-Senior Positions

S&P Equivalent Rating and RBA Risk Weight	2010 Exposure £m	2009 Exposure £m
AAA: 12%	241	699
AA: 15%	256	1,283
A+: 18%	32	384
A: 20%	218	395
A-: 35%	167	265
BBB+: 50%	14	279
BBB: 75%	47	254
BBB-: 100%	113	281
BB+: 250%	112	258
BB: 425%	92	337
BB-: 650%	6	248
Below BB- Unrated: Deduction	250	2,594
Total	1,548	7,277

Tranches Backed by Non-Granular Pools

S&P Equivalent Rating and RBA Risk Weight	2010 Exposure £m	2009 Exposure £m
AAA: 20%	2,309	2,991
AA: 25%	1,549	1,493
A+: 35%	4	90
A: 35%	1,045	576
A-: 35%	550	675
BBB+: 50%	-	111
BBB: 75%	309	148
BBB-: 100%	68	108
BB+: 250%	-	14
BB: 425%	14	-
Below BB- Unrated: Deduction	119	183
Total	5,967	6,389

TOTAL

S&P Equivalent Rating	2010 Exposure £m	2009 Exposure £m
Super Senior Positions	-	82
AAA	23,032	36,494
AA	7,364	5,694
A+	1,591	1,085
A	1,987	1,905
A-	1,089	1,505
BBB+	561	784
BBB	713	530
BBB-	534	522
BB+	464	737
BB	187	484
BB-	212	248
Below BB- Unrated: Deduction	778	4,240
Total	38,512	54,310
Value adjustments taken to reserves	(492)	(3,801)
Deduction from capital	(286)	(439)
Total Credit Risk Exposure	37,734	50,070

Remaining capital requirements in relation to Landale are calculated under the Standardised Approach and relate to positions in a sponsored vehicle funded by Landale. As at 31 December 2010, the total credit risk exposure in respect of these positions amounted to £nil (2009: £222m). An analysis, by risk weight under the Standardised Approach, is provided in the table below.

Risk Weight %	2010 Credit Risk Exposure £m	2010 Risk Weighted Asset £m	2010 Capital Requirement £m	2010 Deduction from Capital £m
20%	-	-	-	-
100%	-	-	-	-
Total	-	-	-	-

Risk Weight %	2009 Credit Risk Exposure £m	2009 Risk Weighted Asset £m	2009 Capital Requirement £m	2009 Deduction from Capital £m
20%	202	40	3	-
100%	20	20	2	-
Total	222	60	5	-

CREDIT RISK MITIGATION

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

INTERNAL CONTROL

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

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

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

Credit scoring: In its principal retail portfolios, the Group uses statistically based decisioning techniques (primarily credit scoring models). Divisional risk departments review model effectiveness, while new models and model changes are referred by them to divisional model governance committees for approval. The most material changes are referred to the Group Model Governance and Approvals Committee.

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

Controls over rating systems: The Group has established an independent team in Group Risk that sets common minimum standards, designed to ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements. Internal rating systems are developed by risk functions either in the business units or divisions, with the business unit managing directors having ownership of the systems. Line management takes responsibility for ensuring the validation of the rating systems, supported and challenged by independent specialist functions in their respective division.

Cross-border and cross-currency exposures: Country limits are authorised by the country limits panel, taking into account economic, financial, political and social factors. Group policies stipulate that these limits must be consistent with, and support the approved business and strategic plans of the Group.

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 countries and more vulnerable sectors and segments. Exposures are monitored to prevent an excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending, but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.

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

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

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

Risk assurance and oversight: Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes, and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Group

credit risk assurance, a group level function comprising forty seven experienced credit professionals, is also in place. In conjunction with divisional and group risk senior management, this team carries out independent risk based credit reviews, providing individual business unit assessment of the effectiveness of risk management practices and adherence to risk controls across the diverse range of the Group's wholesale and retail businesses and activities, facilitating a wide range of audit, assurance and review work. These include cyclical ('standard') credit reviews, non-standard reviews, project reviews, credit risk rating model reviews and bespoke assignments, including impairment reviews as required. The work of group credit risk assurance continues to provide executive and senior management with assurance and guidance on credit quality, effectiveness of credit risk controls and accuracy of impairments.

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 receivables;

– charges over financial instruments such as debt securities and equities; and

– guarantees received from third parties.

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

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

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

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

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

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.

GUARANTEES

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

EXPORT CREDIT AGENCIES

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

CREDIT DERIVATIVES

Credit derivatives are a method of transferring credit risk from one counterparty (the protection buyer) to another (the protection seller). In return for a risk premium, the protection seller agrees to make a payment (or series of payments) to the protection buyer in the event of the occurrence of a stipulated event. Further details are included within the Counterparty Credit Risk section of the document. Capital relief under regulatory requirements is restricted to the following types of credit derivative: Credit Default Swaps; Total Return Swaps; and Credit Linked Notes (to the extent of their cash funding).

In respect of a Credit Default Swap, various credit events (including non-payment, restructuring, moratorium, bankruptcy) affecting the obligor, can trigger settlement. Settlement usually takes place by the protection buyer delivering a credit obligation of the obligor (e.g. a bond or loan) to the protection seller, in return for a cash payment at par.

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

Under a Credit Linked Note, the protection buyer will issue a bond or note which is linked to a credit obligation of the obligor. The bond or note is purchased by the protection seller (at par) and it will receive a coupon on the bond or note (market rate and spread). If a credit event occurs, the bond or note is redeemed by the protection buyer at an agreed price which is less than the issue price. If no credit event occurs, the bond or note will be redeemed at par by the protection buyer.

OTHER CREDIT RISK TRANSFERS

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

EXPOSURES COVERED BY ELIGIBLE COLLATERAL, GUARANTEES AND CREDIT DERIVATIVES

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

The use of credit derivatives and collateral in relation to securitisation positions and counterparty credit risk exposures respectively are discussed further within the Securitisations and Counterparty Credit Risk sections of the document.

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

	2010 Exposures covered by eligible financial collateral £m	2010 Exposures covered by other eligible collateral £m	2010 Exposures covered by guarantees £m	2010 Exposures covered by credit derivatives £m	2010 TOTAL £m
Exposures subject to the IRB Approach					
Advanced IRB Approach					
Corporate - Main			-	-	-
Corporate - SME			-	-	-
Central governments and central banks			-	-	-
Institutions			-	-	-
Foundation IRB Approach					
Corporate - Main	5,183	10,762	116	663	16,724
Corporate - SME	133	8,172	12	-	8,317
Corporate - Specialised lending	65	-	1	-	66
Central governments and central banks	-	-	495	-	495
Institutions	1,196	3,873	873	41	5,983
Retail IRB Approach					
Retail - Residential mortgages	-	-	-	-	-
Retail - Qualifying revolving retail exposures	-	-	-	-	-
Retail - Other retail	-	-	-	-	-
Retail - SME	-	-	-	-	-
Other IRB Approach					
Corporate - Specialised lending	245	-	-	-	245
Total - IRB Approach	6,822	22,807	1,497	704	31,830
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	-	-	-
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	-	-	-	-
Institutions	1	-	-	-	1
Corporates	1,853	-	191	112	2,156
Retail	174	-	-	-	174
Secured on real estate property	46	-	505	-	551
Past due items	1	-	2	-	3
Short term claims on institutions or corporates	-	-	-	-	-
Total - Standardised Approach	2,075	-	698	112	2,885
TOTAL	8,897	22,807	2,195	816	34,715

Key Movements

- Foundation IRB exposures covered by a form of credit risk mitigation (as specified above) have increased following the transfer of Advanced IRB portfolios to the Foundation IRB Approach. Advanced IRB exposures covered by eligible financial collateral and other eligible collateral were not disclosed in the prior year in line with credit risk mitigation disclosure requirements.

The impact of the above eligible financial collateral, guarantees and credit derivatives on exposures risk weighted under the Standardised Approach is disclosed on pages 68 to 72.

Further details on collateral held against retail mortgage lending and an analysis of repossessed collateral can be found in the Notes to the Consolidated Financial Statements, 2010 Lloyds Banking Group plc Annual Report and Accounts, pages 256 to 257.

	2009 Exposures covered by eligible financial collateral £m	2009 Exposures covered by other eligible collateral £m	2009 Exposures covered by guarantees £m	2009 Exposures covered by credit derivatives £m	2009 TOTAL £m
Exposures subject to the IRB Approach					
Advanced IRB Approach					
Corporate - Main			10	-	10
Corporate - SME			103	-	103
Central governments and central banks			-	-	-
Institutions			-	840	840
Foundation IRB Approach					
Corporate - Main	6,087	3,133	351	270	9,841
Corporate - SME	17	-	-	-	17
Corporate - Specialised lending	48	-	-	-	48
Central governments and central banks	-	-	641	-	641
Institutions	2,643	4,226	1,020	1,273	9,162
Retail IRB Approach					
Retail - Residential mortgages	-	-	-	-	-
Retail - Qualifying revolving retail exposures	-	-	-	-	-
Retail - Other retail	-	-	40	-	40
Retail - SME	-	-	-	-	-
Other IRB Approach					
Corporate - Specialised lending	103	-	-	-	103
Total - IRB Approach	8,898	7,359	2,165	2,383	20,805
Exposures subject to the Standardised Approach					
Central governments and central banks	-	-	-	-	-
Regional governments or local authorities	-	-	-	-	-
Administrative bodies and non-commercial undertakings	-	-	-	-	-
Institutions	-	-	-	-	-
Corporates	1,164	-	210	-	1,374
Retail	164	-	93	-	257
Secured on real estate property	54	-	394	-	448
Past due items	-	-	56	-	56
Short term claims on institutions or corporates	-	-	-	-	-
Total - Standardised Approach	1,382	-	753	-	2,135
TOTAL	10,280	7,359	2,918	2,383	22,940

COUNTERPARTY CREDIT RISK

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

INTERNAL CAPITAL AND CREDIT LIMITS

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

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

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

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

SECURING COLLATERAL AND ESTABLISHING CREDIT RESERVES

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

Collateral arrangements are governed by standard agreements (such as Global Master Repurchase Agreements and Credit Support Annexes to ISDA Master Agreements). It is Group Policy that an appropriate master agreement is put in place for all clients prior to trading, any exceptions being subject to specific approval from a senior credit risk officer. This policy also defines minimum acceptable requirements for the negotiation of ISDA and CSA documentation.

To recognise the effects of credit risk mitigation, any agreements must be valid, enforceable, unconditional and irrevocable. In addition, collateral must be transferred to the Bank through the passing of title and should be netable on a portfolio basis. Once these conditions are met, the effect of collateral received is reflected in reductions to all applicable credit exposures and in capital adequacy calculations

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

CORRELATION RISK

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

COLLATERAL REQUIREMENTS IN THE EVENT OF A DOWNGRADE IN CREDIT RATING

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

DERIVATIVE VALUATION ADJUSTMENTS

Details on the application of derivative valuation adjustments by the Group are provided on p.250 and p.251 of the 2010 Lloyds Banking Group plc Annual Report and Accounts.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY MEASUREMENT APPROACH

The credit risk exposure value in respect of counterparty credit risk as at 31 December 2010 was £20.5bn (£48.7bn). An analysis by measurement approach is presented in the table below.

	2010 Credit Risk Exposure £m	2009 Credit Risk Exposure £m
CCR Standardised Approach	-	-
CCR Mark to Market Method	20,550	48,716
CCR Internal Model Method	-	-
Total	20,550	48,716

Key Movements

- The reduction in counterparty credit risk exposures over the year is a result of reduced exposure to central governments and central banks as highlighted in the analysis by exposure class below.

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY EXPOSURE CLASS

An analysis of counterparty credit risk exposures as at 31 December 2010, by exposure class, is presented in the table below.

	2010 Credit Risk Exposure £m	2009 Credit Risk Exposure £m
IRB Approach		
Central governments and central banks	142	29,048
Institutions	7,317	8,027
Corporates	4,577	4,886
Standardised Approach		
Central governments and central banks	2,216	1
Institutions	206	-
Corporates	6,092	6,754
Total	20,550	48,716

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY CONTRACT TYPE

An analysis of counterparty credit risk exposures as at 31 December 2010, by contract type, is presented in the table below.

	2010 Credit Risk Exposure £m	2009 Credit Risk Exposure £m
Interest rate contracts	14,377	36,477
Foreign exchange contracts	1,638	2,978
Equity contracts	284	543
Credit derivatives	404	853
Commodity contracts	21	1,086
Repo contracts	3,826	6,779
Total	20,550	48,716

COUNTERPARTY CREDIT RISK EXPOSURES: ANALYSIS BY RISK WEIGHT APPROACH

An analysis of counterparty credit risk exposures and RWAs as at 31 December 2010, by risk weight approach, is presented in the table below.

	2010 Credit Risk Exposure £m	2010 Risk Weighted Assets £m	2009 Credit Risk Exposure £m	2009 Risk Weighted Assets £m
Standardised Approach	8,514	6,358	6,755	6,553
IRB Approach	12,036	5,207	41,961	5,692
Total	20,550	11,565	48,716	12,245

NET DERIVATIVES CREDIT EXPOSURE

The gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held, net potential future credit exposure ('PFE') and resultant 'net derivatives credit exposure', as at 31 December 2010, are presented separately in the table below.

	2010 £m	2009 £m
Gross positive fair value of contracts	45,323	50,395
Netting benefits	(31,676)	(29,853)
Netted current credit exposure	13,647	20,542
Net potential future credit exposure	7,294	8,434
Collateral held	(2,929)	(3,888)
Total Net Derivatives Credit Exposure	18,012	25,088

Collateral held primarily relates to cash and government securities.

NOTIONAL VALUE OF CREDIT DERIVATIVE TRANSACTIONS

The notional value of credit derivative transactions outstanding at 31 December 2010 was £7.1bn (2009: £19.7bn), an analysis of which is presented in the table below. These transactions relate entirely to credit default swaps.

	2010 Notional Value £m	2009 Notional Value £m
Own credit portfolio – protection bought	5,274	14,391
Own credit portfolio – protection sold	1,834	5,282
Total	7,108	19,673

MARKET RISK

DEFINITION

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

RISK APPETITE

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

This statement of the Group's overall appetite for market risk is reviewed and approved annually by the Board. With the support of the Group Asset and Liability Committee, the Group Chief Executive allocates this risk appetite across the Group. Individual members of the Group Executive Committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

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

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

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

Risk also arises from the margin of interbank rates over central bank rates. A further banking risk arises from competitive pressures on product terms in existing loans and deposits, which sometimes restricts the Group in its ability to change interest rates applying to customers in response to changes in interbank and central bank rates.

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

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

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

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

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

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

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

MEASUREMENT

The following market risk measures are used for risk reporting and setting risk appetite limits and triggers:

- Value at Risk: for short term liquid positions a 1-day 95 per cent VaR is used; for structural positions a 1-year 95 per cent VaR is used.

- Standard Stresses: Interest Rates 25bp; Equities 10 per cent; Credit Spreads relative 30 per cent widening.

- Bespoke Extreme Stress Scenarios: e.g. stock market crash.

Both VaR and standard stress measures are also used in setting divisional market risk appetite limits and triggers.

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. Trading book VaR (1-day 99 per cent) is back-tested daily against profit and loss.

The Group's VaR Model permissions allow it to calculate Pillar 1 market risk capital requirements for the trading book. VaR models are also used by the Group for internal risk measurement of the trading book. Model permissions across both Lloyds TSB and HBOS heritages cover general interest rate and foreign exchange risk. In addition, the Lloyds TSB model also covers specific risk and is complemented by the Incremental Default Risk Charge ('IDRC'), while the HBOS model covers inflation risk. The capital charge is based on the 10 day 99% VaR calculated by the models.

The Group uses an historical simulation methodology to calculate VaR for the trading book. This methodology consists of calculating historical daily price movements for a full range of market risk factors. The historical daily price movements are applied to positions to create a distribution of hypothetical daily profit and loss scenarios. The hypothetical daily changes in portfolio value are ranked, and the 95th and 99th percentile worst losses are identified.

The Group compares daily profit and loss with VaR calculated at a 1 day 99% confidence level on a daily basis. The purpose of this analysis is to provide an indication of how well the VaR model's output, a VaR forecast, has described the corresponding trading outcome. Analysis is performed at the aggregate trading book level, and individual trading desk level. The Group also compares hypothetical profit or loss with the VaR calculated at a 1 day 99% confidence level on a daily basis. Hypothetical profit or loss is the profit or loss that would have resulted assuming that the portfolio remains unchanged from one day to the next.

The FSA categorises a VaR model as green, amber or red in accordance with the number of exceptions observed over the back-testing period. The Group’s trading books maintained their green model status in 2010.

2010 Backtesting Results **(Clean P&L versus 1 day 99% VaR)**	**Zone**	**Number of reported exceptions**
Lloyds TSB	**Green**	**4 or less**
HBOS	**Green**	**4 or less**

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

Valuation Principles

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

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

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

Banking – Trading Assets and Other Treasury Positions

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the years ended 31 December 2010 and 2009 based on the Group's global trading positions was as detailed in the table below.

	2010 Close £m	2010 Average £m	2010 Maximum £m	2010 Minimum £m	2009 Close restated £m
Interest rate risk	3.9	4.4	8.0	2.3	7.1
Foreign exchange risk	0.4	0.4	0.8	0.1	1.1
Equity risk	-	-	0.2	-	-
Credit spread risk	1.6	2.4	4.3	1.2	4.1
Inflation risk	0.3	0.2	0.7	-	0.2
Total VaR	6.2	7.4	13.0	4.2	12.5

2009 VaR has been restated to reflect trading risk only. Risk relating to the funding of the lending business is reported in the Banking – Non-Trading section below.

The risk of loss measured by the VaR model is the potential loss in earnings given the confidence level and assumptions noted above. The total and average trading VaR does not assume any diversification benefit across the five risk types, which now includes inflation. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole. The Group internally uses VaR as the primary measure for all trading book positions arising from short term market facing activity.

Banking – Non-Trading

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

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

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

The following table shows, split by material currency, Lloyds Banking Group sensitivities as at 31 December 2010 to an immediate up and down 25 basis points change to all interest rates.

	2010 Up 25bps £m	2010 Down 25bps £m	2009 Up 25bps £m	2009 Down 25bps £m
Sterling	(86.9)	88.4	66.6	(66.4)
US Dollar	11.1	(11.4)	(5.5)	5.6
Euro	8.9	(9.0)	4.4	(4.4)
Australian Dollar	(1.2)	1.2	2.2	(2.3)
Other	(3.0)	3.1	(0.2)	0.2
Total	(71.1)	72.3	67.5	(67.3)

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

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

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

Pension Schemes

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

The schemes' main exposures are to equity risk, real rate risk and credit spread risk. Accounting for the pension schemes under International Accounting Standard ('IAS')19 spreads any adverse impacts of these risks over time.

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 2010 and 2009. Foreign exchange risk arises predominantly from overseas holdings of equities. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. Opening and closing numbers only have been provided as this data is not volatile and consequently is not tracked on a daily basis.

	2010 £m	2009 £m
Equity risk (impact of 10% fall pre-tax)	(367.4)	(383.6)
Interest rate risk (impact of 25 basis point reduction pre-tax)	82.1	64.0
Credit spread risk (impact of 30% widening)	(163.0)	(156.4)

MITIGATION

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

Banking – Non-Trading Activities

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

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

Insurance Activities

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

MONITORING

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

Banking Activities

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

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

Insurance Activities

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

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

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

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

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

MARKET RISK CAPITAL REQUIREMENT

As at 31 December 2010 the capital requirement in respect of market risk in the trading book amounted to £338m (2009: £289m).

Approach / Risk	2010 Capital Requirement £m	2009 Capital Requirement £m
Internal Models Approach	200	168
Standardised Approach		
Interest rate position risk requirement	133	110
Foreign currency position risk requirement	5	10
Commodity position risk requirement	-	1
Total	338	289

OPERATIONAL RISK

DEFINITION

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

There are a number of categories of operational risk:

Legal and regulatory

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

Customer treatment

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

People

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

Supplier management

The risk of reductions in earnings and / or value through financial or reputational loss from services with outsourced partners or third-party suppliers.

Customer processes

The risk of reductions in earnings and / or value, through financial or reputational loss, resulting from poor externally facing business processes. Customer process risk includes customer transaction and processing errors due to incorrect capturing of customer information and / or system failure.

Financial crime

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

Money laundering and sanctions

The risk of reductions in earnings and / or value, through financial or reputational loss, associated with failure to comply with prevailing legal and regulatory obligations on activities related to money laundering, sanctions and counter terrorism, these losses may include censure, fines or the cost of litigation.

Security

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

IT systems

The risk of reductions in earnings and / or value through financial or reputational loss resulting from the development, delivery and maintenance of effective IT solutions.

Change

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

Organisational infrastructure

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

RISK APPETITE

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

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

The Group encourages and maintains an appropriately balanced legal and regulatory compliance culture and promotes policies and procedures to enable businesses and their staff to operate in accordance with the laws, regulations and voluntary codes which impact on the Group and its activities.

EXPOSURES

By its very nature, operational risks can arise from a wide range of the Group's activities that involve people, processes and systems. The Group's principal operational risks relate to the Group's ability to attract, retain and motivate its people, the rate and scale of change arising from the Group's integration programme, the way in which the Group treats its customers and the legal and regulatory environment in which it operates.

The Group continues to face risks relating to its ability to attract, retain, and develop high calibre talent, as a result of challenges arising from ongoing regulatory and public interest in remuneration practices, delivery of the Group's integration commitments; and uncertainty from EU state aid requirements and Independent Commission on Banking proposals on banking reform.

The integration programme continues to be one of the largest integration exercises undertaken by a financial services firm. The breadth of the integration programme is such that all parts of the Group are impacted to a large or small degree, with the greatest impact being on the Retail bank. Although now over two years into the successful implementation of the programme, there continue to be delivery risks as the programme moves into its final phase of execution.

Customer treatment and how the Group manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of the Group'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, which includes, for example PPI.

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation within the UK and overseas with which the Group has to comply, along with new or proposed legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. This is particularly the case in the current market environment, which is witnessing increased levels of government and regulatory intervention in the banking sector.

MEASUREMENT

Both Lloyds TSB and HBOS had operational risk Advanced Measurement Approach ('AMA') waiver permissions, granted by the FSA, enabling the use of an internal capital model for calculating regulatory capital. As part of its integration programme, Lloyds Banking Group is in the process of moving to The Standardised Approach ('TSA') and, in anticipation of this, calculated regulatory capital for the year ended 31 December 2010 on the basis of TSA.

MITIGATION

The Group's operational risk management framework consists of the following key components:

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

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

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

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

– The development of Key Risk Indicators for management reporting.

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

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

The Group purchases insurance to mitigate certain operational risk events.

MONITORING

Business unit risk exposure is aggregated at divisional level and reported to Group Risk where a group-wide report is prepared. The report is discussed at the monthly Group Operational and Regulatory Risk Committee. This committee can escalate matters to the Chief Risk Officer, or higher committees if appropriate.

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

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

OPERATIONAL RISK CAPITAL REQUIREMENT

As at 31 December 2010, the capital requirement in respect of operational risk amounted to £2,532m (2009: £2,027m) of which £nil (2009: £1,982m) has been derived under the Advanced Measurement Approach and £2,532m (2009: £45m) under The Standardised Approach.

APPENDIX 1

LLOYDS TSB BANK GROUP

CAPITAL RESOURCES AND CAPITAL REQUIREMENTS

LLOYDS TSB BANK GROUP CAPITAL RESOURCES

The capital resources of Lloyds TSB Bank Group as at 31 December 2010 are presented in the table below.

	31 December 2010		31 December 2009 [1]	
	£m	£m	£m	£m
Core tier 1				
Ordinary share capital and reserves		47,709		13,753
Regulatory post-retirement benefit adjustments		(1,052)		249
Available-for-sale revaluation reserve		943		1,441
Cash flow hedging reserve		125		30
Other items		305		(1)
		48,030		15,472
Less: deductions from core tier 1				
Goodwill and other intangible assets		(5,224)		(2,127)
Other deductions		(214)		(1,053)
Core tier 1 capital		42,592		12,292
Perpetual non-cumulative preference shares				
Preference share capital		1,948		3,030
Innovative tier 1 capital instruments				
Preferred securities		4,904		4,928
Less: restriction in amount eligible		-		(2,097)
Less: deductions from tier 1				
Other deductions		(69)		-
Total tier 1 capital		49,375		18,153
Total tier 1 capital (excluding innovative tier 1)	*44,471*		*15,322*	
Tier 2				
Available-for-sale revaluation reserve in respect of equities		462		6
Undated subordinated debt		2,136		1,914
Innovative capital restricted from tier 1		-		2,097
Eligible provisions		2,468		25
Dated subordinated debt		16,290		4,711
Less: deductions from tier 2				
Other deductions		(283)		(1,053)
Total tier 2 capital		21,073		7,700
Total tier 2 capital (including innovative tier 1)	*25,977*		*10,531*	
Supervisory deductions				
Unconsolidated investments – life		(10,042)		(4,586)
Unconsolidated investments – other		(3,070)		(596)
Total supervisory deductions		(13,112)		(5,182)
Total Capital Resources		57,336		20,671
Risk Weighted Assets		406,372		174,472
Core tier 1 ratio (%)		10.5%		7.0%
Tier 1 capital ratio (%)		12.2%		10.4%
Total capital ratio (%)		14.1%		11.8%

[1] Restated to reflect a prior year adjustment to available-for-sale revaluation reserves.

Key Movements

- The increase in the capital resources and RWAs of Lloyds TSB Bank Group primarily reflects the inclusion of heritage HBOS capital resources and RWAs following the transfer of the holding in HBOS plc from Lloyds Banking Group plc to Lloyds TSB Bank plc on 1 January 2010.

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

The risk weighted assets and Pillar 1 capital requirements of Lloyds TSB Bank Group as at 31 December 2010 are presented in the table below.

(All figures are in £m)	2010 Risk Weighted Assets £m	2010 Pillar 1 Capital Requirements £m	2009 Risk Weighted Assets £m	2009 Pillar 1 Capital Requirements £m
CREDIT RISK				
Exposures subject to the IRB Approach				
Foundation IRB Approach				
Corporate - Main	74,720	5,978	47,437	3,795
Corporate - SME	20,285	1,623	6,114	489
Corporate - Specialised lending	7,428	594	11,014	881
Central governments and central banks	1,290	103	877	70
Institutions	4,371	350	2,179	174
Retail IRB Approach				
Retail - Residential mortgages	60,950	4,876	36,141	2,892
Retail - Qualifying revolving retail exposures	24,765	1,981	10,103	808
Retail - Other retail	17,690	1,415	13,775	1,102
Retail - SME	2,069	166	2,396	192
Other IRB Approaches				
Corporate - Specialised lending	6,397	512	3,143	252
Equities – Exchange traded	179	14	-	-
Equities – Private equity	3,217	257	-	-
Equities - Other	2,133	171	-	-
Securitisation positions	8,954	716	5,965	477
Non Credit Obligation Assets	-	-	1,454	116
Total - IRB Approach	234,448	18,756	140,598	11,248
Exposures subject to the Standardised Approach				
Central governments and central banks	60	5	83	7
Regional governments or local authorities	14	1	-	-
Administrative bodies and non-commercial undertakings	294	24	16	1
Institutions	292	23	204	16
Corporates	40,965	3,277	4,705	376
Retail	7,560	604	1,558	125
Secured on real estate property	35,582	2,847	1,365	109
Past due items	15,286	1,223	135	11
Items belonging to regulatory high risk categories	236	19	4,067	325
Securitisation positions	28	2	-	-
Short term claims on institutions or corporates	824	66	-	-
Other items	23,351	1,868	5,593	448
Total - Standardised Approach	124,492	9,959	17,726	1,418
Total Credit Risk	358,940	28,715	158,324	12,666
COUNTERPARTY CREDIT RISK				
IRB Approach	5,207	417	4,478	358
Standardised Approach	6,358	508	-	-
Total Counterparty Credit Risk	11,565	925	4,478	358
MARKET RISK				
Internal Models Approach	2,494	200	1,604	128
Standardised Approach				
Interest Rate position risk requirement	1,657	133	4	-
Foreign Currency position risk requirement	61	5	105	9
Commodity position risk requirement	5	-	9	1
Total Market Risk	4,217	338	1,722	138
OPERATIONAL RISK				
Advanced Measurement Approach	-	-	9,948	796
Standardised Approach	31,650	2,532	-	-
Total Operational Risk	31,650	2,532	9,948	796
TOTAL	406,372	32,510	174,472	13,958

APPENDIX 2

BOS GROUP

CAPITAL RESOURCES AND CAPITAL REQUIREMENTS

BOS GROUP CAPITAL RESOURCES

The capital resources of BOS Group as at 31 December 2010 are presented in the table below.

	31 December 2010		31 December 2009 [1]	
	£m	£m	£m	£m
Core tier 1				
Ordinary share capital and reserves		19,842		22,147
Available-for-sale revaluation reserve		899		1,395
Cash flow hedging reserve		415		839
Other items		230		150
		21,386		24,531
Less: deductions from core tier 1				
Goodwill and other intangible assets		(459)		(565)
Other deductions		(132)		(1,476)
Core tier 1 capital		20,795		22,490
Perpetual non-cumulative preference shares				
Preference share capital		-		800
Innovative tier 1 capital instruments				
Preferred securities		700		698
Less: deductions from tier 1				
Other deductions		(25)		-
Total tier 1 capital		21,470		23,988
Total tier 1 capital (excluding innovative tier 1)	*20,770*		*23,290*	
Tier 2				
Available-for-sale revaluation reserve in respect of equities		346		22
Undated subordinated debt		4,819		5,206
Eligible provisions		1,750		1,669
Dated subordinated debt		8,244		8,691
Less: deductions from tier 2				
Other deductions		(157)		(1,476)
Total tier 2 capital		15,002		14,112
Total tier 2 capital (including innovative tier 1)	*15,702*		*14,810*	
Supervisory Deductions				
Unconsolidated investments		(1,672)		(1,062)
Total Capital Resources		34,800		37,038
Risk Weighted Assets		250,598		322,866
Core tier 1 ratio (%)		8.3%		7.0%
Tier 1 capital ratio (%)		8.6%		7.4%
Total capital ratio (%)		13.9%		11.5%

[1] Restated to reflect a prior year adjustment to available-for-sale revaluation reserves.

BOS GROUP RISK WEIGHTED ASSETS AND PILLAR 1 CAPITAL REQUIREMENTS

The risk weighted assets and Pillar 1 capital requirements of BOS Group as at 31 December 2010 are presented in the table below.

(All figures are in £m)	2010 Risk Weighted Assets £m	2010 Pillar 1 Capital Requirements £m	2009 Risk Weighted Assets £m	2009 Pillar 1 Capital Requirements £m
CREDIT RISK				
Exposures subject to the IRB Approach				
Advanced IRB Approach				
Corporate - Main	-	-	65,914	5,273
Corporate - SME	-	-	19,021	1,522
Central governments and central banks	-	-	132	11
Institutions	-	-	7,009	561
Foundation IRB Approach				
Corporate - Main	31,350	2,508	-	-
Corporate - SME	10,809	865	-	-
Central governments and central banks	49	4	-	-
Institutions	2,711	217	-	-
Retail IRB Approach				
Retail - Residential mortgages	42,438	3,395	41,221	3,298
Retail - Qualifying revolving retail exposures	12,993	1,039	13,751	1,100
Retail - Other retail	5,059	405	6,990	559
Retail - SME	-	-	126	10
Other IRB Approaches				
Corporate - Specialised lending	1,910	153	4,689	375
Equities - Exchange traded	179	14	432	35
Equities - Private equity	3,217	257	2,534	202
Equities - Other	2,133	171	2,338	187
Securitisation positions	4,117	329	7,673	614
Total - IRB Approach	116,965	9,357	171,830	13,747
Exposures subject to the Standardised Approach				
Central governments and central banks	-	-	-	-
Regional governments or local authorities	13	1	25	2
Administrative bodies and non-commercial undertakings	280	23	307	25
Institutions	90	7	38	3
Corporates	36,043	2,884	48,029	3,842
Retail	5,792	463	6,978	558
Secured on real estate property	33,585	2,687	38,026	3,042
Past due items	14,975	1,198	14,051	1,124
Items belonging to regulatory high risk categories	86	7	2	-
Securitisation positions	28	2	87	7
Short term claims on institutions or corporates	805	64	632	51
Other items	14,374	1,150	18,443	1,475
Total - Standardised Approach	106,071	8,486	126,618	10,129
Total Credit Risk	223,036	17,843	298,448	23,876
COUNTERPARTY CREDIT RISK				
IRB Approach	906	73	1,214	97
Standardised Approach	6,358	508	6,553	524
Total Counterparty Credit Risk	7,264	581	7,767	621
MARKET RISK				
Internal Models Approach	833	66	500	40
Standardised Approach				
Interest Rate position risk requirement	1,034	83	1,374	110
Foreign Currency position risk requirement	20	2	23	2
Total Market Risk	1,887	151	1,897	152
OPERATIONAL RISK				
Advanced Measurement Approach	-	-	14,374	1,150
Standardised Approach	18,411	1,473	380	30
Total Operational Risk	18,411	1,473	14,754	1,180
TOTAL	250,598	20,048	322,866	25,829

APPENDIX 3

LLOYDS BANKING GROUP CAPITAL RESOURCES (FORM 20-F)

LLOYDS BANKING GROUP CAPITAL RESOURCES (FORM 20-F)

The capital resources of the Group as at 31 December 2010, based on the disclosure presented on p.103 of the 2010 Form 20-F filed with the US Securities and Exchange Commission ('SEC'), are provided in the table below for reference.

Ordinary share capital and reserves are £2.3bn lower than presented in the equivalent table on p.22 reflecting a post balance sheet adjustment made in Form 20-F, as referred to on pages F-124 to F-125 (Note 59) of that document.

		2010		2009 [1]
	£m	£m	£m	£m
Core tier 1				
Ordinary share capital and reserves		44,543		44,275
Regulatory post-retirement benefit adjustments		(1,052)		434
Available-for-sale revaluation reserve		285		783
Cash flow hedging reserve		391		305
Other items		306		231
		44,473		46,028
Less deductions from core tier 1				
Goodwill and other intangible assets		(5,224)		(5,779)
Other deductions		(214)		(445)
Core tier 1 capital		39,035		39,804
Perpetual non-cumulative preference shares				
Preference share capital		1,507		2,639
Innovative tier 1 capital instruments				
Preferred securities		4,338		4,956
Less deductions from tier 1				
Other deductions		(69)		-
Total tier 1 capital		44,811		47,399
Total tier 1 capital (excluding innovative tier 1)	*40,473*		*42,443*	
Tier 2				
Available-for-sale revaluation reserve in respect of equities		462		221
Undated subordinated debt		1,968		2,575
Eligible provisions		2,468		2,694
Dated subordinated debt		23,167		20,068
Less restriction in amount eligible		(620)		-
Less deductions from tier 2				
Other deductions		(283)		(445)
Total tier 2 capital		27,162		25,113
Total tier 2 capital (including innovative tier 1)	*31,500*		*30,069*	
Supervisory deductions				
Unconsolidated investments – life		(10,042)		(10,015)
Unconsolidated investments – general insurance and other		(3,070)		(1,551)
Total supervisory deductions		(13,112)		(11,566)
Total Capital Resources		58,861		60,946
Risk Weighted Assets		406,372		493,307
Core tier 1 ratio (%)		9.6%		8.1%
Tier 1 capital ratio (%)		11.0%		9.6%
Total capital ratio (%)		14.5%		12.4%

[1] Restated to reflect a prior year adjustment to available-for-sale revaluation reserves.

APPENDIX 4

REMUNERATION DISCLOSURES

REMUNERATION DISCLOSURES

This section discloses the remuneration awards made by the Group to 155 Code Staff in respect of the 2010 performance year. Additional information summarising the Group's decision-making policies for remuneration are also provided. These disclosures deliver the requirements of the FSA Policy Statement PS10/21 'Implementing CRD3 requirements on the disclosure of remuneration' issued in December 2010. Comparative data has not been provided as this is the first year of disclosure.

Code Staff

The following groups of individuals have been identified as meeting the FSA's criteria for Code Staff including those who may have a material impact on the Group's risk profile:

- Senior Management, Executive Board Directors, members of the Group Executive Committee (GEC) and their respective direct reports;
- Non Executive Directors; and
- Approved Persons performing Significant Influence Functions.

For performance year 2010 there were 155 Code Staff identified across the Group.

Aggregate remuneration expenditure (Code Staff)

	Retail £m	Wholesale £m	Wealth & International £m	Insurance £m	Group Operations £m	Group Functions £m	TOTAL £m
Aggregate remuneration expenditure	12.8	18.4	9.0	6.7	8.2	23.5	78.6

Analysis of remuneration between fixed and variable amounts

	Total	Senior Managers	Others
Number of Code Staff	155	51	104
	£m	£m	£m
Fixed:			
Cash based	38.6	20.0	18.6
Total Fixed Pay	38.6	20.0	18.6
Variable:			
Cash	1.2	0.3	0.9
Retained shares [1]	14.2	9.7	4.5
Deferred shares	24.6	20.8	3.8
(of which is LTIP)	*10.1*	*7.4*	*2.7*
Total Variable Pay	40.0	30.8	9.2

[1] Shares subject to retention period

Analysis of deferred remuneration

	2010 Code Staff £m
Deferred remuneration at 31 December	
Outstanding, vested	-
Outstanding, unvested	317.6
Awarded during the financial year	51.0
Paid out	6.1
Reduced through performance adjustment	-

Analysis of sign-on and severance payments

	2010 Code Staff
Severance payments	
Made during the year	£1.5m
Number of beneficiaries	12
Highest such award to a single person	£0.8m

Decision making process for remuneration policy

There continues to be high levels of interest in remuneration arrangements within the banking sector with particular focus on the Lloyds Banking Group. The Group has sought the views of shareholders and other key stakeholders with regards remuneration, whilst ensuring continued compliance with the FSA Remuneration Code.

The Group has an established Remuneration Committee, which held fifteen meetings in 2010, at which a wide range of matters were discussed. Within the authority delegated by the Board, the Committee is responsible for approving remuneration policy. It takes into account pay and other conditions across the Group. This included the determination of bonus pools based on group performance and risk adjustments; performance conditions on the Long Term Incentive Plan; and individual remuneration packages of Executive Directors and other senior managers, including Code Staff.

The Remuneration Committee has continued with its prudent approach to remuneration while recognising the need to attract, reward and retain key individuals. The Group has continued to reduce the level of risk in the business in reaction to the economic events that had a deep impact on the banking sector. In reaching a decision on the size of the bonus pools, including for Executive Directors, the Committee taken into account the need for adjustments to reflect the Group's current profitability and current and future risks.

The Committee worked closely with the Risk Committee in making its decisions, and as a result:

- There were no salary increases made to the Executive Directors in 2010.
- Any bonuses paid in respect of performance in 2010 have been rigorously tested against targets and balance scorecards. Using risk-adjusted financial and non-financial measures to moderate bonus pools has been successful in promoting long term focus within the senior management team.
- It has ensured that its prudent approach to risk is applied in practice. The Group has exercised downward discretion on the annual bonuses for Executive Directors; the payments are lower than if they were calculated on a purely formulaic basis. Exercising its discretion, the Remuneration Committee has been mindful, amongst other things of key balance sheet metrics, share price performance, the quality of profits, future risks, the appropriate balance of profit between shareholders and employees as well as the competitive environment.
- One hundred percent of any award to Executive Directors has been deferred into shares and will not be released until March 2013 at the earliest. Deferral for all other Code Staff has at a minimum been delivered in line with the FSA Remuneration Code requirements. In order to increase alignment with shareholders, all awards will be subject to adjustment if performance is not sustained.

The approximate make-up of the main components of the package for Executive Directors on an expected value base is comprised of:

- 30% salary: paid in cash;

- 30% short-term incentive: based on financial measures and on a balanced scorecard of non-financial measures; and

- 40% long-term incentive: based on a combination of performance targets comprising earnings per share, economic profit and the achievement of stretching share price targets.

Composition of the Remuneration Committee

The members of the Remuneration Committee during 2010 were Dr Wolfgang Berndt (Chairman until 6 May 2010); Anthony Watson (Chairman from 6 May 2010); Sir Winfried Bischoff; Sir Julian Horn-Smith; Lord Leitch; Glen Moreno (from 1 March 2010 to 17 June 2010); David Roberts (from 01 March 2010) and Tim Ryan (from 1 March 2010).

Role of the relevant stakeholders

The Remuneration Committee has appointed independent consultants to provide advice on a range of matters. During 2010, the Committee conducted a review of independent advisors and appointed Deloitte LLP. Kepler Associates were also retained to advise on other matters specifically relating to executive remuneration.

Eric Daniels, Angie Risley (Group HR Director), Liz Jackson (HR Director, Reward from March 2010) and Harriet Kemp (HR Director, Total Reward until March 2010) provided guidance to the Committee (other than for their own remuneration). Carol Sergeant (Chief Risk Officer) and Tim Tookey (Group Finance Director) also attended the Committee to advise on risk and financial matters.

Link between pay and performance

The appointment of a new Chairman of the Remuneration Committee provided an excellent opportunity to review the structure and quantum of the Group's remuneration. The principal focus was to ensure an appropriate alignment between performance and pay in terms of both business strategy and risk profile.

The Group Remuneration policy is intended to ensure that the remuneration offer is both cost effective and enables the Group to attract and retain Executive Directors and Senior Managers of the highest calibre, motivating them to perform to the highest standards.

The objective is to align individual award with the Group's performance, interests of its shareholders whilst adopting a prudent approach to risk. This allows the Group to balance the requirements of its various stakeholders: customers, shareholders, employees and regulators. This approach is in line with the Association of British Insurers best practice code on remuneration and the FSA Remuneration Code, as the policy seeks to reward long-term value creation whilst not encouraging excessive risk taking.

Annual and long-term incentives are based on stretching performance objectives and targets in the Group Balanced Scorecard. This Balanced Scorecard is derived from the Medium Term Plan which defines the financial and non-financial targets within the agreed risk appetite over a three year period.

In determining the payout under any component of variable pay, the adopted policy is the use of discretion to assess the extent to which performance has been achieved rather than applying a formulaic approach. The annual bonus for Executive Directors is deferred into shares and released over a period of not less than two years, helping to increase alignment with shareholders. All other Code Staff are subject to deferral at least in line with the FSA Remuneration Code. These deferrals are subject to adjustment through the application of malus.

Design and structure of remuneration

Reward is delivered via a combination of fixed (salary) and variable pay (bonus and LTIP). Taking into account the expected value of awards, the performance-related elements of pay make up a considerable proportion of the total remuneration package for Code Staff, whilst maintaining an appropriate balance between the fixed and variable elements.

Salary and fees
All Code Staff receive either a salary or fees (Non-Executive Directors) which reflect market value, role & responsibility and contribution to the Group. Base salaries are reviewed annually, taking into account individual performance and market information (which is provided by salary survey providers such as Towers Watson and supplemented with information from Deloitte LLP). These are normally adjusted from 1 April of the relevant year (1 January for Executive Directors and other GEC members).

The Group aims to pay competitively while being positioned conservatively against the market; it does not seek to align with the highest payers in the sector. In setting pay for Executive Directors and Senior Managers, the Group takes account of relative pay positioning and target levels of variable remuneration opportunity for all levels in the Group. The fees of the Independent Non-Executive Directors are agreed by the Board within a total amount determined by the shareholders.

Annual Bonus
The remuneration approach allows the Group not to pay a bonus when appropriate. Employees, including Code Staff, with poor performance ratings will receive little or no bonus.

All Code Staff, excluding Non-Executive Directors, are eligible to receive an annual bonus. For Code Staff on the Group Annual Bonus, the award will reflect the extent to which the Group's annual objectives have been met under the balanced scorecard approach.

Performance measurement / assessment
Bonus awards for Executive Directors are based upon individual contribution and overall corporate results. Bonus opportunity is driven by corporate performance based on profit before tax and economic profit, together with divisional achievement and individual performance. Individual targets relevant to improving overall business performance are contained in a Balanced Scorecard and are grouped under the following headings:

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

Discretion is applied at all stages including the determination of accruals and finalisation of pools and is applied by the Group senior management and the Remuneration Committee. The discretionary approach allows full flexibility to aligning bonus pools to business performance.

Deferral and vesting
To ensure that the interests of Lloyds Banking Group and its employees are aligned with those of the shareholders, and that the approach to risk management supports the interests of all stakeholders, a proportion of bonus above certain thresholds is deferred into Lloyds Banking Group Shares. The 2010 annual bonus for Executive Directors is deferred in shares until at least March 2013 and is beyond the requirements of the FSA Remuneration Code. For all other Code Staff, bonus is deferred in line with the FSA Code requirements. This deferred amount is subject to adjustment when there is (a) reasonable evidence of employee misbehaviour or mistake, (b) the business unit suffers a down or (c) material failure of risk management.

The committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deem this appropriate.

Long-term incentives

The purpose of the Long Term Incentive Plan is to reflect the relative and absolute performance over the long-term, taking into account an external measure of value creation, a measure of the extent to which the return on capital invested in the Group is in excess of a benchmark return and a direct measure of the profits generated for shareholders. Its purpose is to reward the creation of sustained growth in shareholder value and to encourage alignment with shareholders.

Performance measurement / assessment
During 2010, the Remuneration Committee was particularly mindful of driving sustainable performance through the cycle without encouraging excessive risk taking. The Committee has consulted widely with shareholders on the topic of performance measures and sharing the growth in the Group appropriately between shareholders and Senior Managers. The Committee believes that the performance measures for the 2011 LTIP award should be Economic Profit (EP), Earnings per share (EPS) and for the Executive Directors and other selected individuals, Absolute Total Shareholder Return (ATSR). The measures capture risk measurement, profit growth, and shareholder experience and align shareholder experience and reward.

Deferral and vesting
At this time the Remuneration Committee is not in a position to determine the metrics that will attach to the LTIP measures as the new Group Chief Executive is completing a strategic review of the business. It is critical to ensure that the 2011 LTIP is aligned with the new strategic direction of the Company and the goals set over the medium term. The Remuneration Committee intends to determine the appropriate metrics following the completion of the strategic review and to consult with shareholders on the metrics prior to communicating them.

Governance and risk management

An essential component of the Group’s approach to remuneration is the governance process that underpins it. The overarching purpose of the Remuneration Committee is to consider, agree and recommend to the board an overall remuneration policy and philosophy for the Group that is aligned to its long-term business strategy, business objectives, risk appetite and values and recognises the interests of relevant stakeholders.

Economic Profit is a key measure by which the Group manages the business. This measure takes into account the level of capital required to generate profits as well as the risks taken. The same level of profit generated at lower risk results in higher economic profit. Economic Profit also measures risk based on an assessment of how the business will perform through the economic cycle.

The use of Economic profit in the Group's incentive plans encourages executives to take a prudent approach to risk. The Group also has non-financial measure of performance against risk objectives in both the annual and long-term plans for executives.

The Group has a robust governance framework with the Remuneration Committee reviewing all compensation decisions for Executive Directors, Senior Managers and Code Staff. This approach to governance is cascaded through the Group with Divisional Remuneration Committees having oversight for all other employees. Control function employees are assessed and their remuneration determined jointly by the relevant business Director and the appropriate Control Function Director. To ensure compliance with the FSA Remuneration Code, the Committee also approves remuneration for Code Staff and that of senior risk and compliance officers.

The Remuneration Committee monitors the application of the authority delegated to the Group Executive Committee and the Divisional Remuneration Committees to ensure that policies and principles are being fairly and consistently applied. The Committee liaises closely with the Risk Committee and the risk function in relation to the risk-adjusted performance measures, including consideration of both current and future risk. Together the management of remuneration and risk form an integral part of the Board’s determination of Group corporate strategy.

The Remuneration Committee's terms of reference are available from the Company Secretary and are displayed on the Group's website: www.lloydsbankinggroup.com. These terms were updated in January 2011 to ensure continued compliance with the FSA Code.

Further details on directors' remuneration and other remuneration can be found in the Directors' Remuneration Report and Other Remuneration Disclosures located on pages 124 to 142 of the 2010 Lloyds Banking Group plc Annual Report and Accounts.

APPENDIX 5

GLOSSARY

GLOSSARY

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

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

Arrears
A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Such a customer is also said to be in a state of delinquency. When a customer is in arrears, the entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue.

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

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

Basel III
The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and due to be phased in from 1 January 2013 onwards.

Basis point
One hundredth of a per cent (0.01 per cent). 100 basis points is 1 per cent. Used in quoting movements in interest rates or yields on securities.

Collateralised Debt Obligations (CDO)
A security issued by a third party which references ABSs or other assets purchased by the issuer. Lloyds Banking Group has invested in instruments issued by other banking groups, including Collateralised Loan Obligations and Commercial Real Estate CDOs.

Collateralised Loan Obligations (CLO)
A security backed by the repayments from a pool of commercial loans. CLOs are usually structured products with different tranches whereby senior classes of holder receive repayment before other tranches are repaid.

Collectively assessed loan impairment provision
A provision established following an impairment assessment on a collective basis for homogeneous groups of loans, such as credit card receivables and personal loans, that are not considered individually significant and for loan losses that have been incurred but not separately identified at the balance sheet date.

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

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

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

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

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

Core tier 1 capital
As defined by the FSA mainly comprising shareholders' equity and equity non-controlling interests after deducting goodwill, other intangible assets and other regulatory deductions.

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

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

Credit derivatives
A credit derivative is a financial instrument that derives its value from the credit rating of an underlying instrument carrying the credit risk of the issuing entity. The principal type of credit derivatives are credit default swaps, which are used by the Group as part of its trading activity and to manage its own exposure to credit risk. 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 corporate and commercial banking loans in combination with external funding.

Credit risk spread (or credit spread)

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

Credit Valuation Adjustments (CVA)

These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.

Debt restructuring

This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as reducing the debt or interest charged on the loan.

Debt securities

Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.

Debt securities in issue

These are unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Expected Loss (EL)

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

Exposure at Default (EAD)

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

External Credit Assessment Institutions (ECAI)

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

Fair value adjustment

Fair value adjustments arise on acquisition when assets and liabilities are acquired at fair values that are different from the carrying values in the acquired company. In respect of the Group's acquisition of HBOS the principal adjustments were write-downs in respect of loans and advances to customers and debt issued.

Foundation Internal Ratings Based (FIRB) Approach

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

Guaranteed mortgages

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

Impaired loans

Impaired loans are loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.

Impairment allowances

Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.

Impairment losses

An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the asset's value is lower than its carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate.

Individually / collectively assessed

Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.

Individually assessed loan impairment provisions

Impairment loss provisions for individually significant impaired loans are assessed on a case-by-case basis, taking into account the financial condition of the counterparty, any guarantor and the realisable value of any collateral held.

Loans past due

Loans are past due when a counterparty has failed to make a payment when contractually due.

Loss Given Default (LGD)

Loss given default (LGD) represents the estimated proportion of an EAD amount that will be lost in the event of default. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.

Mortgage related assets

Assets which are referenced to underlying mortgages.

Private equity investments

Private equity is equity securities in operating companies not quoted on a public exchange. Investment in private equity often involves the investment of capital in private companies or the acquisition of a public company that results in the delisting of public equity. Capital for private equity investment is raised by retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Point-in-time (PIT)

Estimates of PD (or other measures) made on a point-in-time (PIT) basis generally cover a short time horizon (usually a 12 month period) and are sensitive to changes in the economic cycle. This differs from a through-the-cycle (TTC) basis which uses long run average economic and risk data to reduce such sensitivity.

Probability of Default (PD)

Probability of default (PD) represents an estimate of the likelihood that a customer will default on their obligation within a 12 month time horizon.

Qualifying Revolving Retail

Qualifying Revolving Retail Exposures (QRRE) relate to revolving, unsecured retail exposures that, to the

Exposure (QRRE) extent they are not drawn, are immediately and unconditionally cancellable. Such exposures include credit cards and overdraft facilities.

Renegotiated loans Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. In the latter case renegotiation can result in an extension of the due date of payment or repayment plans under which the Group offers a concessionary rate of interest to genuinely distressed borrowers. This will result in the asset continuing to be overdue and will be impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset. In other cases, renegotiation will lead to a new agreement, which is treated as a new loan.

Repurchase agreements or 'repos' Short-term funding agreements which allow a borrower to sell a financial asset, such as ABS or Government bonds as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.

Retail Internal Ratings Based (Retail IRB) Approach The application of the Advanced Internal Ratings Based (AIRB) Approach to retail portfolios is commonly referred to as the Retail Internal Ratings Based (Retail IRB) Approach.

Retail loans Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as mortgages and credit card balances.

Residential Mortgaged Backed Securities (RMBS) Residential Mortgage Backed Securities are a category of ABS. They are securities that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).

Risk weighted assets (RWAs) A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with FSA rules.

Securitisation Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. Securitisation is the process by which ABS are created. A company sells assets to a special purpose entity which then issues securities backed by the assets. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. Assets used in securitisations include mortgages to create mortgage backed securities or residential mortgage-backed securities (RMBS) as well as commercial mortgage backed securities (CMBS). The Group has established several securitisation structures as part of its funding and capital management activities. These generally use mortgages, corporate loans and credit cards as asset pools.

Special Purpose Entities (SPEs) SPEs are entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set-up under securitisation programmes, and as conduits. Where the Group has control of these entities or retains the risks and rewards relating to them they are consolidated within the Group's results.

Standardised Approach The Standardised Approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by ECAIs to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements.

Student loan related assets Assets which are referenced to underlying student loans.

Subordinated liabilities Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Synthetic CDO A security that is similar in structure to a CDO whereby the pool of referenced assets is created synthetically usually by credit default swaps.

The Standardised Approach (TSA) A standardised measure for calculating operational risk capital requirements based on the three year average of the aggregate risk weighted relevant indicators of the underlying business. The relevant indicators are derived from total income.

Through-the-cycle (TTC) See **Point-in-time (PIT)**

Tier 1 capital A measure of a bank's financial strength defined by the FSA. It captures Core tier 1 capital plus other tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.

Tier 2 capital A component of regulatory capital defined by the FSA, mainly comprising qualifying subordinated loan capital, certain non-controlling interests and eligible collective impairment allowances.

Value at Risk (VaR) Value at Risk is an estimate of the potential loss in earnings which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a confidence level of 95 per cent.

Write downs The depreciation or lowering of the value of an asset in the books to reflect a decline in their value, or expected cash flows.

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