Lloyds TSB Bank plc

Report and Accounts
2011

Member of Lloyds Banking Group

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Results
The consolidated income statement on page 17 shows a loss attributable to equity shareholders for the year ended 31 December 2011 of £868 million.

Principal activities
Lloyds TSB Bank plc (the Bank) and its subsidiary undertakings (the Group) provide a wide range of banking and financial services through branches and offices in the UK and overseas.

The Group's revenue is earned through interest and fees on a broad range of financial services products including current and savings accounts, personal loans, credit cards and mortgages within the retail market; loans and capital market products to commercial, corporate and asset finance customers; life, pensions and investment products; general insurance; and private banking and asset management.

Business review
The Group's loss before tax for the year of £1,531 million, compared to a profit of £725 million for 2010, has arisen largely as a result of the £3,200 million charge in respect of payment protection insurance, offset by liability management gains arising on the restructuring of the Group's long-term funding.

The trading surplus decreased by £5,598 million, or 46 per cent, from £12,130 million to £6,532 million, comprising a £170 million increase in net interest income, a £2,982 million reduction in other income, net of insurance claims, and a £2,786 million increase in operating expenses, including the effect of the £3,200 million charge in respect of payment protection insurance in the current year.

Net interest income increased by £170 million, from £12,686 million to £12,856 million. A reduction in margins, reflecting increased funding costs, was offset by an income statement credit relating to the amounts allocated to unit holders in the Open-Ended Investment Companies included in the consolidated results of the Group and by a one-off benefit resulting from the Group's offer to exchange outstanding for newly issued subordinated debt securities.

Other income declined by £16,029 million from £31,768 million in 2010 to £15,739 million in 2011, largely due to a reduction in net trading income in the Group's insurance businesses arising as a result of the effect of market conditions on policyholder assets. In addition, net trading income in the Group's banking operations also reduced significantly as a result of unfavourable market conditions, including a charge of £718 million for the net debit and credit valuation adjustments reflecting movements in credit risk on derivative balances. Offsetting the reductions in net trading income were liability management gains totalling £2,682 million for the current year, compared to £352 million in 2010. A £599 million gain arose following the exchange of outstanding subordinated debt securities for new subordinated debt, while the remaining £2,083 million gain resulted from the repurchase at fair value of senior debt held by subsidiaries of Lloyds Banking Group plc by means of the issue of subordinated debt securities.

Offsetting the decline in the insurance businesses' net trading income is a decrease in the insurance claims expense from £19,088 million in 2010 to £6,041 million in the current year, also reflecting the impact of adverse market conditions.

Total operating expenses increased to £16,022 million in 2011, compared to £13,236 million in 2010. The increase reflects the £3,200 million charge in respect of payment protection insurance and the non-repetition of the pension curtailment gain of £910 million arising in 2010. Continuing cost synergies on the combination of the Lloyds TSB and HBOS businesses have decreased operating expenses. In addition, 2010 expenses included a provision of £500 million for customer goodwill payments, while 2011 expenses incorporate a provision of £175 million in relation to German insurance business litigation.

A reduction of £2,858 million in impairment losses, from £10,952 million in 2010 to £8,094 million in the current year, reflects continued improving business quality and portfolio trends, resulting from the Group's prudent risk appetite, with significant reductions in the Group's retail, wholesale and international businesses.

Total assets at 31 December 2011 were £988,366 million, £20,366 million, or 2 per cent, lower compared to £1,008,732 million at 31 December 2010. The decrease reflects the continuing disposal of assets which are outside of the Group's risk appetite, customer deleveraging and de-risking and subdued demand in lending markets.

Customer deposits increased by £8,101 million, or 2 per cent, to £424,377 million compared to £416,276 million at 31 December 2010, following growth in retail savings balances, in particular in tax-free ISA balances, and after a reduction of £12,296 million arising on the repurchase at fair value of senior debt held by subsidiaries of Lloyds Banking Group plc by means of the issue of

subordinated debt securities. This issue of dated subordinated notes was largely responsible for the increase of £7,721 million in subordinated liabilities, to £37,330 million from £29,609 million at 31 December 2010. Overall, however, the funding requirement declined, with deposits from banks decreasing £10,553 million from £50,363 million at 31 December 2010 to £39,810 million at 31 December 2011 and a reduction of £43,813 million in debt securities in issue from £228,317 million to £184,504 million at 31 December 2011. Derivative balances were £16,056 million higher at £58,701 million, compared to £42,645 million at 31 December 2010, reflecting largely the impact on the carrying value of derivative contracts of adverse global economic conditions, but also increased hedging activity within the Group.

Shareholders' equity increased by £3,708 million, from £46,891 million to £50,599 million at 31 December 2011, reflecting gains on available-for-sale financial assets and cash flow hedges and a capital contribution of £2,340 million from Lloyds Banking Group plc, offset by the loss for the year.

The Group's capital ratios at 31 December 2011 improved with a tier 1 capital ratio of 14.3 per cent, compared to 12.2 per cent at 31 December 2010, and a total capital ratio of 14.8 per cent, compared to 14.1 per cent at 31 December 2010. During the year, risk-weighted assets were reduced by £54,031 million, or 13 per cent, from £406,372 million to £352,341 million at 31 December 2011.

Financial risk management objectives and policies

Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in note 55 on page 118. A discussion of the principal risks and uncertainties faced by the Group is set out on pages 8 to 14. This information is incorporated into this report by reference. Additional information can be found in the annual report of Lloyds Banking Group plc, the Bank's ultimate parent, which does not form part of this report.

Going concern

The going concern of the Bank and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Bank and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies as discussed in note 1 on page 24 and additionally have considered projections for the Group's capital and funding position. Having considered these, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Directors

The names of the directors of the Bank are shown on page 6. Changes to the composition of the Board since 1 January 2011 up to the date of this report are shown below:

	Joined the Board	Retired from the Board
Mr A Horta-Osório (became Group Chief Executive on 1 March 2011)	17 January 2011	
Mr J E Daniels		28 February 2011
Mr A G Kane		18 May 2011
Mrs H A Weir		18 May 2011
Ms S V Weller	1 February 2012	
Mr G T Tate		6 February 2012

Mr T J W Tookey, Lord Leitch and Sir Julian Horn-Smith will retire from the Board on 24 February, 29 February and 17 May 2012, respectively.

Directors' interests

The directors are also directors of Lloyds Banking Group plc and their interests in shares in Lloyds Banking Group plc are shown in the report and accounts of that company.

Directors' conflicts of interest

The Board, as permitted by the Bank's articles of association, has authorised all potential conflicts of interest that have been declared by individual directors. Decisions regarding these conflicts of interest could be and were only taken by directors who had no interest in the matter. In taking the decision, the directors acted in a way they considered, in good faith, would be most likely to promote the Bank's success. The directors have the ability to impose conditions, if thought appropriate, when granting authorisation. Any authorities given are reviewed at least every 15 months. No director is permitted to vote on any resolution or matter where he or she has an actual or potential conflict of interest. The Board confirms that no material conflicts were reported to it during the year.

Directors' indemnities

The directors of the Bank, including the former directors who retired during the year and since the year end, have entered into individual deeds of indemnity with Lloyds Banking Group plc which constituted 'qualifying third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' for the purposes of the Companies Act 2006. In addition, Lloyds Banking Group plc has granted a deed of indemnity through deed poll which constituted 'third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' to the directors of the Bank's subsidiary companies, including to former directors who retired during the year and since the year end. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the directors who joined the boards in 2011 and 2012. The indemnities remain in force for the duration of a director's period of office. The deeds indemnify the directors to the maximum extent permitted by law. Deeds for existing directors are available for inspection at the Bank's registered office.

Share capital

Information about share capital and dividends is shown in notes 46 and 50 on pages 87 and 89 and is incorporated into this report by reference.

Employees

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

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

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

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

Lloyds Banking Group is committed to providing employees with comprehensive coverage of the economic and financial issues affecting the Group. We have established a full suite of communication channels, including an extensive face-to-face briefing programme which allows us to update our employees on our performance and any financial issues throughout the year.

Policy and practice on payment of creditors

The Bank has signed up to the 'Prompt Payment Code' published by the Department for Business Innovation and Skills (BIS), regarding the making of payments to suppliers. Information about the 'Prompt Payment Code' may be obtained by visiting www.promptpaymentcode.org.uk.

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

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is 33. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2011 bears to the aggregate of the amounts invoiced by suppliers during the year.

Essential business contracts

There are no persons with whom the Bank has contractual or other arrangements that are considered essential to the business of the Bank.

Significant contracts

Details of related party transactions are set out in note 52 on pages 95 to 97.

Research and development activities

During the ordinary course of business the Bank develops new products and services.

Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group and Bank financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Bank and of the profit or loss of the Bank

and Group for that period. In preparing these financial statements, the directors are required to: select suitable accounting policies and then apply them consistently; make judgements and accounting estimates that are reasonable and prudent; and state whether applicable IFRSs as adopted by the European Union have been followed.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and the Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the financial statements is placed on the website www.lloydsbankinggroup.com. The directors are responsible for the maintenance and integrity in relation to the Bank on that website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the current directors, whose names are shown on page 6 of this annual report, confirms that, to the best of his or her knowledge:

- the financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities and financial position of the Bank and Group and the profit or loss of the Group;
- the business review includes a fair review of the development and performance of the business and the position of the Bank and Group; and
- the principal risks and uncertainties faced by the Bank and the Group are set out on pages 8 to 14.

Auditors and audit information

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

A resolution will be proposed at the 2012 annual general meeting to reappoint PricewaterhouseCoopers LLP as auditors. The Bank's audit committee is satisfied that the external auditors remain independent and effective.

On behalf of the Board

Harry F Baines
Company Secretary
23 February 2012

Company Number 2065

Directors

Sir Winfried Bischoff *Chairman*

A Horta-Osório *Group Chief Executive*

T J W Tookey *Group Finance Director* (until 24 February 2012)

A M Frew

Sir Julian Horn-Smith (until 17 May 2012)

Lord Leitch (until 29 February 2012)

G R Moreno

D L Roberts

T T Ryan, Jr

M A Scicluna

A Watson CBE

S V Weller

Forward looking statements

This annual report 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 TSB Bank plc and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds TSB Bank plc 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 or Lloyds Banking Group plc's credit ratings; the ability to derive cost savings and other benefits including, without limitation, as a result of the integration of HBOS and the Group's Simplification Programme; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets including Eurozone instability; 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 Lloyds Banking Group plc and the Group as a result of HM Treasury's investment in the Lloyds Banking Group plc; the ability to complete satisfactorily the disposal of certain assets as part of the Lloyds Banking Group plc'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. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors.

The 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, 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 the Group to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward looking statements contained in this annual report are made as of the date hereof, and Lloyds TSB Bank plc expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this annual report to reflect any change in Lloyds TSB Bank plc's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Principal risks and uncertainties

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

LIQUIDITY AND FUNDING

Risk Definition

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.

Principal Risks

Liquidity and funding continues to remain a key area of focus for the Group and the industry as a whole. Like all major banks, the Group is dependent on confidence in the short and long term wholesale funding markets. Should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding, its ability to fund its financial obligations could be impacted.

The combination of right-sizing the balance sheet and continued development of the retail deposit base has seen the Group's wholesale funding requirement reduce in the past year. The progress the Group has made to date in diversifying its funding sources has further strengthened its funding base.

During the first half of 2011 the Lloyds Banking Group accelerated term funding initiatives and the run down of certain non-core asset portfolios allowing a further reduction in total government and central bank facilities. Lloyds Banking Group repaid its remaining drawings under the Bank of England SLS scheme in full during 2011. Outstandings under the Credit Guarantee Scheme reduced in line with their contractual maturities, with £23.5 billion remaining at end December. The outstanding amount matures during 2012.

The second half of 2011 has seen more difficult funding markets as investor confidence was impacted by concerns over the US debt ceiling and subsequent downgrade. This was followed by increased fears over Eurozone sovereign debt levels, downgrades and possible defaults and concerns are ongoing over the potential downside effects from financial market volatility. Despite this Lloyds Banking Group continued to fund adequately, maintaining a broadly stable stock of primary liquid assets during the year and meeting its regulatory liquidity ratio targets at all times.

Liquidity is managed at the aggregate Lloyds Banking Group level, with active monitoring at both business unit and Group level. Monitoring and control processes are in place to address both internal and regulatory requirements. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

The Lloyds Banking Group carries out stress testing of its liquidity position against a range of scenarios, including those prescribed by the FSA. Lloyds Banking Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

Lloyds Banking Group's stress testing framework considers these factors, including the impact of a range of economic and liquidity stress scenarios over both short and longer term horizons. Internal stress testing results at 31 December 2011 show that Lloyds Banking Group has liquidity resources representing more than 130 per cent of modelled outflows from all wholesale funding sources, corporate deposits and rating dependent contracts under the Group's severe liquidity stress scenario. In 2011, Lloyds Banking Group has maintained its liquidity levels in excess of the ILG regulatory minimum (FSA's Individual Liquidity Adequacy Standards) at all times. Funding projections show Lloyds Banking Group will achieve the proposed Basel 3 liquidity and funding requirements in advance of expected implementation dates.

Lloyds Banking Group's stress testing shows that further credit rating downgrades may reduce investor appetite for some of the Group's liability classes and therefore funding capacity. In the fourth quarter of 2011, Lloyds Banking Group experienced downgrades in its long-term rating of between one and two notches from three of the major rating agencies. The impact that Lloyds Banking Group experienced following the downgrades were consistent with the Group's modelled outcomes based on the stress testing framework. Lloyds Banking Group has materially reduced its wholesale funding in recent years and operates a well diversified funding platform which together lessen the impact of stress events.

Lloyds Banking Group's borrowing costs and issuance in the capital markets are dependent on a number of factors, and increased cost or reduction of capacity could materially adversely affect the Group's results of operations, financial condition and prospects. In particular, reduction in the credit rating of Lloyds Banking Group or deterioration in the capital markets' perception of the Group's financial resilience, could significantly increase its borrowing costs and limit its issuance capacity in the capital markets. The impact on the Lloyds Banking Group's funding cost is subject to a number of assumptions and uncertainties and is therefore impossible to quantify precisely.

The downgrades that Lloyds Banking Group experienced in the fourth quarter of 2011, did not significantly change its borrowing costs, reduce its issuance capacity or require significant collateral posting. Lloyds Banking Group notes the recent announcements from Moody's placing the ratings of 114 European financial institutions, including Lloyds Banking Group, on review for downgrade. Even in the case of a simultaneous two notch downgrade from all rating agencies, the Group would remain investment grade.

At 31 December, Lloyds Banking Group had £202 billion of highly liquid unencumbered assets in its liquidity portfolio which are available to meet cash and collateral outflows. This liquidity is available for deployment at immediate notice, subject to complying with regulatory requirements, and is a key component of the Group's liquidity management process.

Mitigating Actions
The Group takes many mitigating actions with respect to this principal risk, key examples include:

Lloyds Banking Group has maintained its liquidity levels in excess of the ILG regulatory minimum (FSA's Individual Liquidity Adequacy Standards) at all times. Funding projections show that Lloyds Banking Group will achieve the proposed Basel III liquidity and funding metrics in advance of expected implementation dates. The Liquidity Coverage Ratio (LCR) is due to be implemented on 1 January 2015 and the Net Stable Funding Ratio (NSFR) has a 1 January 2018 implementation date. The European Commission released its proposal for implementing Basel III into Europe (CRDIV) in July 2011 and we note that discussions over the final detail are ongoing.

Lloyds Banking Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the FSA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The key dependencies on successfully funding the Lloyds Banking Group's balance sheet include the continued functioning of the money and capital markets; successful right-sizing of the Lloyds Banking Group's balance sheet; the repayment of the government Credit Guarantee Scheme facilities in accordance with the agreed terms; no more than limited further deterioration in the UK's and the group's credit rating; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets. Additionally, Lloyds Banking Group has entered into a number of EU state aid related obligations to achieve reductions in certain parts of its balance sheet by the end of 2014. These are assumed within the Lloyds Banking Group's funding plan. The requirement to meet this deadline may result in Lloyds Banking Group having to provide funding to support these asset reductions and/or disposals and may also result in a lower price being achieved.

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

Principal Risks
Arising in the retail, wholesale, commercial and wealth and International operations, reflecting the risks inherent in the Group's lending activities and, to a much lesser extent in the Insurance operations in respect of investment of own funds. Adverse changes in the credit quality of the Group's UK and/or international borrowers and counterparties, or in their behaviour, would be expected to reduce the value of the Group's assets and materially increase the Group's write-downs and allowances for impairment losses. Credit risk can be affected by a range of factors, including, inter alia, increased unemployment, reduced asset values, lower consumer spending, increased personal or corporate insolvency levels, reduced corporate profits, increased interest rates or higher tenant defaults. Over the last four years, the global banking crisis and economic downturn has driven cyclically high bad debt charges. These have arisen from the Group's lending to:

- Wholesale customers (including those in wealth and international): where companies continue to face difficult business conditions. Impairment levels have reduced materially since the peak of the economic downturn and more aggressive risk appetite when elevated corporate default levels and illiquid commercial property markets resulted in heightened impairment charges. The UK economy remains fragile. Consumer and business confidence is low, consumer spending has been falling over the past year, the reduction in public sector spending is deepening and exports are failing to offset domestic weakness. The possibility of further economic weakness remains. Financial market instability represents an additional downside risk.The Group has exposure in both the UK and internationally, including Europe, Ireland, USA and Australia, particularly in commercial real estate lending, where we have a high level of lending secured on secondary and tertiary assets.

– Retail customers: This portfolio will remain strongly linked to the economic environment, with inter alia house price falls, unemployment increases, consumer over-indebtedness and rising interest rates possible impacts to the secured and unsecured retail exposures.

Mitigating Actions
The Group takes many mitigating actions with respect to this principal risk, key examples being that the Group follows a relationship based business model with risk management processes, appetites and experienced staff in place.

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

Principal Risks
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. This is particularly the case in the current market environment, which continues to witness high levels of government and regulatory intervention in the banking sector.

Lloyds Banking Group faces increased political and regulatory scrutiny as a result of the Group's perceived size and systemic importance following the acquisition of HBOS Group.

Independent Commission on Banking
The Government appointed an independent Commission on Banking (ICB) to review possible measures to reform the banking system and promote stability and competition. The ICB published its final report on 12 September 2011 putting forward recommendations to require ring-fencing of the retail activities of banks from their investment banking activities and additional capital requirements beyond those required under current drafts of the Capital Requirements Directive IV. The Report also makes recommendations in relation to the competitiveness of the UK banking market, including enhancing the competition remit of the new Financial Conduct Authority (FCA), implementing a new industry-wide switching solution by September 2013, and improving transparency. The ICB, which following the final report was disbanded, had the authority only to make recommendations, which the Government could choose to accept or reject.

The ICB specifically recommended in relation to Lloyds Banking Group's EU mandated branch disposal (Project Verde), that, to create a strong challenger in the UK banking market, the entity which results from the divestiture should have a share of the personal current account (PCA) market of at least 6 per cent (although this does not need to arise solely from the current accounts acquired from the Company) and a funding position at least as strong as its peers. The ICB did not specify a definitive timeframe for the divested entity to achieve a 6 per cent market share of PCAs but recommended that a market investigation should be carefully considered by competition authorities if 'a strong and effective challenger' has not resulted from Lloyds Banking Group's divestiture by 2015. The ICB did not recommend explicitly that Lloyds Banking Group should increase the size of the Project Verde disposal agreed with the European Commission but recommended that the Government prioritise the emergence of a strong new challenger over reducing market concentration through a 'substantially enhanced' divestiture by Lloyds Banking Group.

The Government published its response to the ICB recommendations on 19 December 2011. The Government supported the recommendation that an entity with a larger share of the PCA market than the 4.6 per cent originally proposed might produce a more effective competitor. In relation to Lloyds Banking Group's announcement that it was to pursue exclusive negotiations with the Co-operative Group, the Government commented that such a transaction would deliver a significant enhancement of the PCA market share, with the share divested by Lloyds Banking Group combining with the Co-operative Group's existing share to create a competitor with approximately 7-8 per cent. The Government also stated that the execution of the divestment is a commercial matter, and it has no intention of using its shareholding to deliver an enhancement.

New Regulatory Regime
On 27 January 2012, the Government published the Financial Services Bill. The proposed new UK regulatory architecture will see the transition of regulatory and supervisory powers from the FSA to the new Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA). The PRA will be responsible for supervising banks, building societies and other large firms. The FCA will focus on consumer protection and market regulation. The Bill is also proposing new responsibilities and powers for the FCA.

The most noteworthy are the proposed greater powers for the FCA in relation to competition and the proposal to widen its scope to include consumer credit. The Bill is expected to take effect in early 2013.

In April 2011, the FSA commenced an internal reorganisation as a first step in a process towards the formal transition of regulatory and supervisory powers from the FSA to the new FCA and PRA in 2013. Until this time the responsibility for regulating and supervising the activities of the Group and its subsidiaries will remain with the FSA. On 2 April the FSA will introduce a new 'twin peaks' model and the intention is to move the FSA as close as possible to the new style of regulation outlined in the Bill. There will be two independent groups of supervisors for banks, insurers and major investment firms covering prudential and conduct. (All other firms (those not dual regulated) will be solely supervised by the conduct supervisors).

In addition, the European Banking Authority, the European insurance and Occupational Pensions Authority and the European securities and Markets Authority as new EU Supervisory Authorities are likely to have greater influence on regulatory matters across the EU.

Capital and Liquidity
Evolving capital and liquidity requirements continue to be a priority for Lloyds Banking Group. The Basel Committee on Banking Supervision has put forward proposals for a reform package which changes the regulatory capital and liquidity standards, the definition of 'capital', introduces new definitions for the calculation of counterparty credit risk and leverage ratios, additional capital buffers and development of a global liquidity standard. Implementation of these changes is expected to be phased in between 2013 and 2018.

Anti Bribery
The Bribery Act 2010 came fully into force on 1 July 2011. It enhances previous laws on bribery and is supported by some detailed guidance issued by the Ministry of Justice on the steps a business needs to take to embed 'adequate procedures' to prevent bribery. A company convicted of failing to have 'adequate procedures' to prevent bribery could receive an unlimited fine. The Group operates a Group-wide Anti-Bribery Policy, applicable to all of its businesses, operations and employees, which incorporates the requirements of the UK Bribery Act 2010.

Sanctions
The Group takes very seriously its responsibilities for complying with legal and regulatory sanctions requirements in all the jurisdictions in which it operates. In order to assist adherence to relevant economic sanctions legislation, the Group has enhanced its internal compliance processes including those associated with customer and payment screening. The Group has continued the delivery of a programme of staff training regarding policies and procedures for detecting and preventing economic sanctions non-compliance.

US Regulation
Significant regulatory initiatives from the US impacting the Group include the Dodd-Frank Act (which imposes specific requirements for systemic risk oversight, securities market conduct and oversight, bank capital standards, arrangements for the liquidation of failing systemically significant financial institutions and restrictions to the ability of banks to engage in proprietary trading activities known as the 'Volcker Rule'). The Act will have both business and operational implications for the Group within and beyond the US. In addition the Foreign Account Tax Compliance Act (FATCA) requires non-US financial institutions to enter into disclosure agreements with the US Treasury and all non-financial non-US entities to report and or certify their ownership of US assets in foreign accounts or be subject to 30 per cent withholding tax.

European Regulation
At a European level, the pace of regulatory reform has increased with a number of new directives or changes to existing directives planned in the next 12 months including a revised Markets in Financial Instruments Directive, Transparency Directive, Insurance Mediation Directive and a Fifth Undertakings in Collective Investments in Transferable Securities Directive as well as a proposed Directive regulating Packaged Retail Investment Products.

Mitigating Actions
The Group takes many mitigating actions with regard to this principal risk, key examples include:

Independent Commission on Banking
Lloyds Banking Group continues to play a constructive role in the debate with the Government and other stakeholders on all issues under consideration in relation to the ICB's recommendations.

New Regulatory Regime
Lloyds Banking Group continues to work closely with the regulatory authorities and industry associations to ensure that it is able to identify and respond to regulatory changes and mitigate against risks to the Group and its stakeholders.

Capital and Liquidity
Lloyds Banking Group is continuously assessing the impacts of regulatory developments which could have a material effect on the Group and is progressing its plans to implement regulatory changes and directives through change management programmes.

Anti Bribery
The Group has no appetite for bribery and explicitly prohibits the payment, offer, acceptance or request of a bribe, including 'facilitation payments'.

The Group has enhanced its internal compliance processes including those associated with payment screening, colleague training and hospitality.

US and European Regulation
Lloyds Banking Group is continuously assessing the impacts of regulatory developments which could have a material effect on the Group and is progressing with its plans to implement regulatory changes and directives through change management programmes. The Group is also continuing to progress its plans to achieve Solvency II compliance.

MARKET RISK

Risk Definition
The risk of reductions in earnings and/or value, through financial or reputational loss, from unfavourable market moves; including changes in, and increased volatility of, interest rates, market-implied inflation rates, credit spreads, foreign exchange rates, equity, property and commodity prices.

Principal Risks
The Group has a number of Market risks, the principal ones being:

– There is a risk to the Group's banking income arising from the level of interest rates and 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 restrict the Group in its ability to change interest rates applying to customers in response to changes in interbank and central bank rates.
– Equity market movements and changes in credit spreads impact the Group's results.
– The main equity market risks arise in the life assurance companies and staff pension schemes.
– Credit spread risk arises in the life assurance companies, pension schemes and banking businesses.

Continuing concerns about the fiscal position in Eurozone countries resulted in increased credit spreads in the areas affected, and fears of contagion affected the Euro and widened spreads between central bank and interbank rates.

Mitigating Actions
The Group takes many mitigating actions with respect to this principal risk, key examples include:

Market risk is managed within a Lloyds Banking Group Board approved framework using a range of metrics to monitor against stated appetite and potential market conditions.

Market Risk is reported regularly to appropriate committees.

The Group's trading activity is small relative to our peers and is not considered to be a principal risk.

CUSTOMER TREATMENT

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

Principal Risks
Customer treatment and how the Group manages its customer relationships affect all aspects of the Group's operations and are closely aligned with achievement of Lloyds Banking Group's strategic vision to be the best bank for customers. As a provider of a wide range of financial services products and numerous distribution channels to an extremely broad and varied customer base, we

face significant conduct risks, such as: products or services not meeting the needs of our customers; sales processes which could result in selling products to customers which do not meet their needs; failure to deal with a customer's complaint effectively where we have got it wrong and not met customer expectations.

There remains a high level of scrutiny regarding the treatment of customers by financial institutions from regulatory bodies, the press and politicians. The FSA in particular continues to drive focus on conduct of business activities through its supervision activity.

There is a risk that certain aspects of the Group's business may be determined by regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable in their opinion. The Group may also be liable for damages to third parties harmed by the conduct of its business.

Mitigating Actions
The Group takes many mitigating actions with respect to this principal risk, key examples include:

Lloyds Banking Group's Conduct Risk Strategy and supporting framework have been designed to support our vision and strategic aim to put the customer at the heart of everything we do. Lloyds Banking Group have developed and implemented a framework to enable us to deliver the right outcomes for our customers, which is supported by Policies and Standards in key areas, including product governance, sales, responsible lending, customers in financial difficulties, claims and complaints handling.

Lloyds Banking Group actively engages with regulatory bodies and other stakeholders in developing its understanding of current customer treatment concerns.

PEOPLE
Risk Definition
The risk of reductions in earnings or value through financial or reputational loss arising from ineffectively leading colleagues responsibly and proficiently, managing people resource, supporting and developing colleague talent, or meeting regulatory obligations related to our people.

Principal Risks
The quality and effectiveness of our people are fundamental to its success. Consequently, the Group's management of material people risks is critical to its capacity to deliver against its long-term strategic objectives. Over the next year the Group's ability to manage people risks successfully may be affected by the following key drivers:

Lloyds Banking Group's continuing structural consolidation and the sale of part of our branch network under Project Verde may result in disruption to our ability to lead and manage our people effectively

The continually changing, more rigorous regulatory environment may impact people strategy, remuneration practices and retention

Macroeconomic conditions and negative media attention on the banking sector may impact retention, colleague sentiment and engagement.

Mitigating Actions
The Group takes many mitigating actions with respect to this principal risk, key examples include:

Strong focus on leadership and colleague engagement, through delivery of strategies to attract, retain and develop high calibre staff together with implementation of rigorous succession planning

A continued focus on people risk management across the Group

Ensuring compliance with regulatory requirements related to Approved Persons and the FSA Remuneration Code, and embedding compliant and appropriate colleague behaviours in line with Group policies, values and people risk priorities

Strengthening risk management culture and capability across the Group, together with further embedding of risk objectives in the colleague performance and reward process.

INSURANCE RISK
Risk Definition
The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claims settlements.

Principal Risks

The major sources of insurance risk are within the insurance businesses and the Group's defined benefit staff pension schemes ('pension schemes'). Insurance risk is inherent in the insurance business and can be affected by customer behaviour. Insurance risks accepted relate primarily to mortality, longevity, morbidity, persistency, expenses, property and unemployment. The primary insurance risk of the Group's pension schemes is related to longevity.

Insurance risk within the insurance businesses has the potential to significantly impact the earnings and capital position of the Insurance Division of the Lloyds Banking Group. For the Group's pension schemes, insurance risk could significantly increase the cost of pension provision and impact the balance sheet of the Group.

Mitigating Actions

The Group takes many mitigating actions with respect to this principal risk, key examples include:

Insurance risk is reported regularly to appropriate committees and boards.

Actuarial assumptions are reviewed in line with experience and in-depth reviews are conducted regularly. Longevity assumptions for the Group's pension schemes are reviewed annually together with other IFRS assumptions. Expert judgement is required.

Insurance risk is controlled by robust processes including underwriting, pricing-to-risk, claims management, reinsurance and other risk mitigation techniques.

STATE FUNDING AND STATE AID

HM Treasury currently holds approximately 40.2 per cent of Lloyds Banking Group plc's ordinary share capital. United Kingdom Financial Investments Limited (UKFI) as manager of HM Treasury's shareholding continues to operate in line with the framework document between UKFI and HM Treasury managing the investment in Lloyds Banking Group plc on a commercial basis without interference in day-to-day management decisions. There is a risk that a change in Government priorities could result in the framework agreement currently in place being replaced leading to interference in the operations of the Group, although there have been no indications that the Government intends to change the existing operating arrangements.

Lloyds Banking Group made a number of undertakings to HM Treasury arising from the capital and funding support, including the provision of additional lending to certain mortgage and business sectors for the two years to 28 February 2011, and other matters relating to corporate governance and colleague remuneration. The lending commitments were subject to prudent commercial lending and pricing criteria, the availability of sufficient funding and sufficient demand from creditworthy customers. These lending commitments were delivered in full in the second year.

The subsequent agreement (known as 'Merlin') between five major UK banks (including Lloyds Banking Group) and the Government in relation to gross business lending capacity in the 2011 calendar year was subject to a similar set of criteria. Lloyds Banking Group delivered in full its share of the commitments by the five banks, both in respect of lending to Small and Medium Sized Enterprises (SMEs) in respect of overall gross business lending. Lloyds Banking Group has made a unilateral lending pledge for 2012 as part of its publicly announced SME charter.

In addition, Lloyds Banking Group is subject to European state aid obligations in line with the Restructuring Plan agreed with HM Treasury and the EU College of Commissioners in November 2009, which is designed to support the long-term viability of the Group and remedy any distortion of competition and trade in the European Union (EU) arising from the State aid given to Lloyds Banking Group.

This has placed a number of requirements on the Lloyds Banking Group including an asset reduction target from a defined pool of assets by the end of 2014 and the disposal of a certain portion of its retail business by the end of November 2013. In June 2011 Lloyds Banking Group issued an Information Memorandum to potential bidders of this retail banking business, which the European Commission confirmed met the requirements to commence the formal sale process for the sale no later than 30 November 2011. On 14 December 2011 Lloyds Banking Group announced that having reviewed the formal offers made, its preferred option was for a direct sale and that it was entering into exclusive discussions with The Co-operative Group. Lloyds Banking Group is also continuing to progress an Initial Public Offering (IPO) in parallel. Lloyds Banking Group continues to work closely with the EU Commission, HM Treasury and the Monitoring Trustee appointed by the EU Commission to ensure the successful implementation of the Restructuring Plan.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS TSB BANK PLC

We have audited the Group and the Bank financial statements (the 'financial statements') of Lloyds TSB Bank plc for the year ended 31 December 2011 which comprise the consolidated income statement, the Group and Bank statements of comprehensive income, the Group and Bank balance sheets, the Group and Bank statements of changes in equity, the Group and Bank cash flow statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

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

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2011 and of the Group's loss and the Group's and Bank's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Bank financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Philip Rivett
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
23 February 2012

a) The maintenance and integrity of the Lloyds Banking Group plc website is the responsibility of the Group directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

for the year ended 31 December 2011

	Note	**2011 £ million**	2010 £ million
Interest and similar income		**26,689**	29,682
Interest and similar expense		**(13,833)**	(16,996)
Net interest income	5	**12,856**	12,686
Fee and commission income		**4,935**	4,992
Fee and commission expense		**(1,391)**	(1,682)
Net fee and commission income[1]	6	**3,544**	3,310
Net trading income	7	**(825)**	16,167
Insurance premium income	8	**8,170**	8,148
Other operating income	9	**4,850**	4,143
Other income		**15,739**	31,768
Total income		**28,595**	44,454
Insurance claims[1]	10	**(6,041)**	(19,088)
Total income, net of insurance claims		**22,554**	25,366
Payment protection insurance provision		**(3,200)**	–
Other operating expenses		**(12,822)**	(13,236)
Total operating expenses	11	**(16,022)**	(13,236)
Trading surplus		**6,532**	12,130
Impairment	12	**(8,094)**	(10,952)
Share of results of joint ventures and associates	13	**31**	(88)
Loss on disposal of businesses	14	**–**	(365)
(Loss) profit before tax		**(1,531)**	725
Taxation	15	**736**	(818)
Loss for the year		**(795)**	(93)
Profit attributable to non-controlling interests		**73**	62
Loss attributable to equity shareholders		**(868)**	(155)
Loss for the year		**(795)**	(93)

[1]See notes 6 and 10.

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

Statements of comprehensive income

for the year ended 31 December 2011

The Group	**2011 £ million**	2010 £ million
Loss for the year	**(795)**	(93)
Other comprehensive income		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	**2,603**	1,231
Income statement transfers in respect of disposals	**(343)**	(399)
Income statement transfers in respect of impairment	**80**	114
Other income statement transfers	**(155)**	(110)
Taxation	**(575)**	(343)
	1,610	493
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**893**	(1,062)
Net income statement transfers	**70**	932
Taxation	**(262)**	35
	701	(95)
Currency translation differences, (tax: nil)	**(84)**	(137)
Other comprehensive income for the year, net of tax	**2,227**	261
Total comprehensive income for the year	**1,432**	168
Total comprehensive income attributable to non-controlling interests	**72**	57
Total comprehensive income attributable to equity shareholders	**1,360**	111
Total comprehensive income for the year	**1,432**	168

The Bank	**2011 £ million**	2010 £ million
Profit (loss) for the year	**1,537**	(280)
Other comprehensive income:		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	**2,708**	924
Income statement transfers in respect of disposals	**(234)**	6
Income statement transfers in respect of impairment	**–**	21
Other income statement transfers	**(78)**	(44)
Taxation	**(603)**	(249)
	1,793	658
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**(10)**	(13)
Net income statement transfers	**8**	41
Taxation	**–**	(8)
	(2)	20
Currency translation differences (tax: nil)	**3**	17
Other comprehensive income for the year, net of tax	**1,794**	695
Total comprehensive income for the year	**3,331**	415

Balance sheets

at 31 December 2011

	Note	The Group		The Bank	
		2011 £ million	2010 £ million	**2011 £ million**	2010 £ million
Assets					
Cash and balances at central banks		**60,722**	38,115	**57,500**	35,585
Items in the course of collection from banks		**1,408**	1,368	**898**	997
Trading and other financial assets at fair value through profit or loss	16	**139,243**	156,276	**4,665**	4,587
Derivative financial instruments	17	**64,842**	49,600	**37,517**	21,322
Loans and receivables:					
Loans and advances to banks	18	**32,606**	30,272	**167,896**	152,596
Loans and advances to customers	19	**584,237**	611,089	**249,113**	251,173
Debt securities	22	**12,470**	25,735	**633**	1,479
		629,313	667,096	**417,642**	405,248
Available-for-sale financial assets	24	**37,952**	42,955	**31,351**	24,951
Held-to-maturity investments	25	**8,098**	7,905	**8,098**	7,905
Investment properties	26	**6,122**	5,997	**–**	–
Investments in joint ventures and associates	13	**334**	429	**6**	6
Goodwill	27	**2,016**	2,016	**–**	–
Value of in-force business	28	**6,638**	7,367	**–**	–
Other intangible assets	29	**3,196**	3,496	**329**	118
Tangible fixed assets	30	**7,673**	8,190	**1,731**	1,531
Current tax recoverable		**428**	550	**830**	828
Deferred tax assets	43	**4,565**	4,204	**3,127**	2,796
Investment in subsidiary undertakings	31	**–**	–	**40,289**	40,155
Retirement benefit assets	42	**1,338**	736	**736**	530
Other assets	32	**14,478**	12,432	**1,257**	1,243
		988,366	1,008,732	**605,976**	547,802

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

Balance sheets

at 31 December 2011

		The Group		The Bank	
Equity and liabilities	Note	**2011 £ million**	2010 £ million	**2011 £ million**	2010 £ million
Liabilities					
Deposits from banks	33	**39,810**	50,363	**154,592**	118,337
Customer deposits	34	**424,377**	416,276	**227,553**	223,812
Items in course of transmission to banks		**844**	802	**487**	506
Trading and other financial liabilities at fair value through profit or loss	35	**24,955**	26,762	**10,905**	11,268
Derivative financial instruments	17	**58,701**	42,645	**35,031**	20,260
Notes in circulation		**1,145**	1,074	**–**	–
Debt securities in issue	36	**184,504**	228,317	**102,237**	115,122
Liabilities arising from insurance contracts and participating investment contracts	37	**79,001**	80,749	**–**	–
Liabilities arising from non-participating investment contracts	39	**49,636**	51,363	**–**	–
Unallocated surplus within insurance businesses	40	**300**	643	**–**	–
Other liabilities	41	**32,525**	30,046	**4,364**	3,800
Retirement benefit obligations	42	**381**	423	**199**	292
Current tax liabilities		**104**	149	**24**	19
Deferred tax liabilities	43	**314**	247	**1**	–
Other provisions	44	**3,166**	1,532	**1,624**	569
Subordinated liabilities	45	**37,330**	29,609	**25,045**	15,574
Total liabilities		**937,093**	961,000	**562,062**	509,559
Equity					
Share capital	46	**1,574**	1,574	**1,574**	1,574
Share premium account	47	**35,533**	35,533	**35,533**	35,533
Other reserves	48	**7,500**	5,272	**2,159**	365
Retained profits	49	**5,992**	4,512	**4,648**	771
Shareholders' equity		**50,599**	46,891	**43,914**	38,243
Non-controlling interests		**674**	841	**–**	–
Total equity		**51,273**	47,732	**43,914**	38,243
Total equity and liabilities		**988,366**	1,008,732	**605,976**	547,802

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

The directors approved the financial statements on 23 February 2012.

Sir Winfried Bischoff
Chairman

António Horta-Osório
Chief Executive

Tim J W Tookey
Finance Director

Statement of changes in equity

for the year ended 31 December 2011

The Group	**Attributable to equity shareholders**					
	Share capital and premium £ million	**Other reserves £ million**	**Retained profits £ million**	**Total £ million**	**Non-controlling interests £ million**	**Total £ million**
Balance at 1 January 2010	10,102	(1,342)	4,660	13,420	293	13,713
Comprehensive income						
(Loss) profit for the year	–	–	(155)	(155)	62	(93)
Other comprehensive income						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	498	–	498	(5)	493
Movements in cash flow hedging reserve, net of tax	–	(95)	–	(95)	–	(95)
Currency translation differences, net of tax	–	(137)	–	(137)	–	(137)
Total other comprehensive income	–	266	–	266	(5)	261
Total comprehensive income	–	266	(155)	111	57	168
Transactions with owners						
Dividends	–	–	–	–	(47)	(47)
Issue of ordinary shares:						
On transfer of HBOS	21,394	–	–	21,394	–	21,394
Other	5,611	–	–	5,611	–	5,611
Reserve arising on transfer of HBOS	–	6,348	–	6,348	–	6,348
Value of employee services:						
Share option schemes	–	–	7	7	–	7
Adjustment on acquisition	–	–	–	–	1,271	1,271
Extinguishment of non-controlling interests	–	–	–	–	(735)	(735)
Change in non-controlling interests	–	–	–	–	2	2
Total transactions with owners	27,005	6,348	7	33,360	491	33,851
Balance at 31 December 2010	37,107	5,272	4,512	46,891	841	47,732
Comprehensive income						
(Loss) profit for the year	**–**	**–**	**(868)**	**(868)**	**73**	**(795)**
Other comprehensive income						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	**–**	**1,611**	**–**	**1,611**	**(1)**	**1,610**
Movements in cash flow hedging reserve, net of tax	**–**	**701**	**–**	**701**	**–**	**701**
Currency translation differences, net of tax	**–**	**(84)**	**–**	**(84)**	**–**	**(84)**
Total other comprehensive income	**–**	**2,228**	**–**	**2,228**	**(1)**	**2,227**
Total comprehensive income	**–**	**2,228**	**(868)**	**1,360**	**72**	**1,432**
Transactions with owners						
Dividends	**–**	**–**	**–**	**–**	**(50)**	**(50)**
Capital contribution	**–**	**–**	**2,340**	**2,340**	**–**	**2,340**
Value of employee services:						
Share option schemes	**–**	**–**	**8**	**8**	**–**	**8**
Change in non-controlling interests	**–**	**–**	**–**	**–**	**(189)**	**(189)**
Total transactions with owners	**–**	**–**	**2,348**	**2,348**	**(239)**	**2,109**
Balance at 31 December 2011	**37,107**	**7,500**	**5,992**	**50,599**	**674**	**51,273**

Further details of movements in the Group's share capital and reserves are provided in notes 46, 47, 48 and 49.

Statement of changes in equity

for the year ended 31 December 2011

The Bank	**Share capital and premium £ million**	**Other reserves £ million**	**Retained profits £ million**	**Total £ million**
	Attributable to equity shareholders			
Balance at 1 January 2010	10,102	(330)	1,051	10,823
Comprehensive income				
Loss for the year	–	–	(280)	(280)
Other comprehensive income				
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	658	–	658
Movements in cash flow hedging reserve, net of tax	–	20	–	20
Currency translation differences, net of tax	–	17	–	17
Total other comprehensive income	–	695	–	695
Total comprehensive income	–	695	(280)	415
Transactions with owners				
Issue of ordinary shares:				
On transfer of HBOS	21,394	–	–	21,394
Other	5,611	–	–	5,611
Total transactions with owners	27,005	–	–	27,005
Balance at 31 December 2010	37,107	365	771	38,243
Comprehensive income				
Profit for the year	**–**	**–**	**1,537**	**1,537**
Other comprehensive income				
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	**–**	**1,793**	**–**	**1,793**
Movements in cash flow hedging reserve, net of tax	**–**	**(2)**	**–**	**(2)**
Currency translation differences, net of tax	**–**	**3**	**–**	**3**
Total other comprehensive income	**–**	**1,794**	**–**	**1,794**
Total comprehensive income	**–**	**1,794**	**1,537**	**3,331**
Transactions with owners				
Capital contribution	**–**	**–**	**2,340**	**2,340**
Balance at 31 December 2011	**37,107**	**2,159**	**4,648**	**43,914**

Cash flow statements

for the year ended 31 December 2011

	Note	The Group		The Bank	
		2011 £ million	2010 £ million	**2011 £ million**	2010 £ million
(Loss) profit before tax		**(1,531)**	725	**640**	(566)
Adjustments for:					
Change in operating assets	57a	**44,052**	31,872	**(30,263)**	21,003
Change in operating liabilities	57b	**(23,142)**	(45,561)	**50,140**	(6,604)
Non-cash and other items	57c	**(2,544)**	10,498	**2,547**	929
Tax (paid) received		**(287)**	209	**(26)**	(32)
Net cash provided by (used in) operating activities		**16,548**	(2,257)	**23,038**	14,730
Cash flows from investing activities					
Purchase of financial assets		**(28,995)**	(46,890)	**(20,062)**	(32,639)
Proceeds from sale and maturity of financial assets		**36,523**	45,999	**15,918**	14,831
Purchase of fixed assets		**(3,226)**	(3,205)	**(847)**	(575)
Proceeds from sale of fixed assets		**2,216**	1,353	**35**	7
Additional capital injections to subsidiaries	57e	**–**	–	**(159)**	(219)
Acquisition of businesses, net of cash acquired	57e	**(13)**	9,011	**–**	–
Disposal of businesses, net of cash disposed	57f	**298**	428	**4**	18
Net cash provided by (used in) investing activities		**6,803**	6,696	**(5,111)**	(18,577)
Cash flows from financing activities					
Dividends paid to non-controlling interests		**(50)**	(47)	**–**	–
Interest paid on subordinated liabilities		**(1,416)**	(1,732)	**(630)**	(872)
Proceeds from issue of subordinated liabilities		**524**	3,237	**–**	3,237
Capital contribution received		**2,340**	–	**2,340**	–
Repayment of subordinated liabilities		**(1,174)**	(684)	**(1,082)**	(353)
Change in non-controlling shareholders		**8**	2	**–**	–
Net cash provided by financing activities		**232**	776	**628**	2,012
Effect of exchange rate changes on cash and cash equivalents		**6**	479	**5**	17
Change in cash and cash equivalents		**23,589**	5,694	**18,560**	(1,818)
Cash and cash equivalents at beginning of year		**62,300**	56,606	**40,389**	42,207
Cash and cash equivalents at end of year	57d	**85,889**	62,300	**58,949**	40,389

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

1 Basis of preparation

The financial statements of Lloyds TSB Bank plc have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) as applied in accordance with the provisions of the Companies Act 2006. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor body. The EU endorsed version of IAS 39 Financial Instruments: Recognition and Measurement relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB. The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

The going concern of the Bank and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Bank and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies which are set out in the Principal risks and uncertainties section under Liquidity and funding on page 8 and additionally have considered projections for the Group's capital and funding position. Taking all of these factors into account, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

In previous years the Group has included annual management charges on non-participating investment contracts within insurance claims. In light of developing industry practice, these amounts (2011: £606 million; 2010: £577 million; 2009: £474 million) are now included within net fee and commission income.

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2011. None of these standards or amendments have had a material impact on these financial statements.

(i) Amendment to IAS 32 *Financial Instruments: Presentation – 'Classification of Rights Issues'*. Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated.

(ii) IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*. Clarifies that when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor, a gain or loss is recognised in the income statement representing the difference between the carrying value of the financial liability and the fair value of the equity instruments issued; the fair value of the financial liability is used to measure the gain or loss where the fair value of the equity instruments cannot be reliably measured.

(iii) *Improvements to IFRSs* (issued May 2010). Amends IFRS 7 *Financial Instruments: Disclosure* to require further disclosures in respect of collateral held by the Group as security for financial assets and sets out minor amendments to other standards as part of the annual improvements process.

(iv) Amendment to IFRIC 14 *Prepayments of a Minimum Funding Requirement*. Applies when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements and permits such an entity to treat the benefit of such an early payment as an asset.

(v) IAS 24 *Related Party Disclosures (Revised)*. Simplifies the definition of a related party and provides a partial exemption from the requirement to disclose transactions and outstanding balances with the government and government-related entities. The Group has taken advantage of an exemption in respect of government and government-related transactions that permits an entity to disclose only transactions that are individually or collectively significant. Details of related party transactions are disclosed in note 52.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2011 and which have not been applied in preparing these financial statements are given in note 58.

2 Accounting policies

The accounting policies are set out below.

a Consolidation

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

(1) Subsidiaries

Subsidiaries include entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Details of the principal subsidiaries are given in note 31.

Investment vehicles, such as Open Ended Investment Companies (OEICs), where the Group has control are consolidated. Control arises when the Group manages the funds and also has a majority beneficial interest. In circumstances where the Group holds a majority beneficial interest, but is not the fund manager, the Group does not consolidate the entity as it does not have the fund manager's decision-making powers over the investment activities of the OEIC necessary to establish control. The interests of parties other than the Group are reported in other liabilities.

Special purpose entities (SPEs) are consolidated if, in substance, the Group controls the entity. A key indicator of such control, amongst others, is where the Group is exposed to the risks and benefits of the SPE.

The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

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

The acquisition method of accounting is used to account for business combinations by the Group. The consideration for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred except those relating to the issuance of debt instruments (see 2e(5)) or share capital (see 2r(1)). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

(2) Joint ventures and associates

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

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

b Goodwill

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

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

c Other intangible assets

Other intangible assets include brands, core deposit intangibles, purchased credit card relationships, customer-related intangibles and both internally and externally generated capitalised software enhancements. Intangible assets which have been determined to have a finite useful life are amortised on a straight line basis over their estimated useful life as follows:

Capitalised software enhancements	up to 5 years
Brands (which have been assessed as having finite lives)	10-15 years
Customer-related intangibles	up to 10 years
Core deposit intangibles	up to 8 years
Purchased credit card relationships	5 years

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

2 Accounting policies (continued)

that an indefinite useful life remains appropriate. In the event that an indefinite life is inappropriate a finite life is determined and an impairment review is performed on the asset.

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

The effective interest rate is calculated on initial recognition of the financial asset or liability by estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Group including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see h below).

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

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

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

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

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either:

– substantially all of the risks and rewards of ownership have been transferred; or
– the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

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

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

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

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

– it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on different bases. The main type of financial assets designated by the Group at fair value through profit or loss are assets backing insurance contracts and investment contracts issued by the Group's life insurance businesses. Fair value designation allows changes in the fair value of these assets to be recorded in the income statement along with the changes in the value of the associated liabilities, thereby significantly reducing the measurement inconsistency had the assets been classified as available-for-sale financial assets.
– the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, with management information also prepared on this basis. As noted in a(2) above, certain of the Group's investments are managed as venture capital investments and evaluated on the basis of their fair value and these assets are designated at fair value through profit or loss.
– where the assets and liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Refer to note 3 (Critical accounting estimates and judgements: Fair value of financial instruments) and note 54(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

2 Accounting policies (continued)

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

– if the financial assets would have met the definition of loans and receivables (but for the fact that they had to be classified as held for trading at initial recognition), they may be reclassified into loans and receivables where the Group has the intention and ability to hold the assets for the foreseeable future or until maturity;
– if the financial assets would not have met the definition of loans and receivables, they may be reclassified out of the held for trading category into available-for-sale financial assets in 'rare circumstances'.

(2) Available-for-sale financial assets
Debt securities and equity shares that are not classified as trading securities, at fair value through profit or loss, 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.

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

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. In cases where the securitisation vehicles are funded by the issue of debt, on terms whereby the majority of the risks and rewards of the portfolio of securitised lending are retained by the Group, these loans and advances continue to be recognised by the Group, together with a corresponding liability for the funding.

(4) Held-to-maturity investments
Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity other than:

– those that the Group designates upon initial recognition as at fair value through profit or loss;
– those that the Group designates as available-for-sale; and
– those that meet the definition of loans and receivables.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method, less any provision for impairment.

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

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

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

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

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

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

2 Accounting policies (continued)

f Derivative financial instruments and hedge accounting
All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and option pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 3 (Critical accounting estimates and judgements: Fair value of financial instruments) and note 54(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

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

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

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

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

(1) Fair value hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk; this also applies if the hedged asset is classified as an available-for-sale financial asset. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity.

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

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

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

h Impairment of financial assets
(1) Assets accounted for at amortised cost
At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition 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.

2 Accounting policies (continued)

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
Impairment is assessed on a collective basis for (1) homogenous groups of loans that are not considered individually impaired, and (2) to cover losses which have been incurred but have not yet been identified on loans subject to individual impairment.

Homogenous groups of loans
In respect of portfolios of smaller balance, homogenous loans, or otherwise where there is no objective evidence of individual impairment, 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, industry sector, 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 in certain cases 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 set out 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.

Incurred but not yet identified impairment
The collective provision also includes provision for inherent losses, that is losses that have been incurred but have not been separately identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. Risk drivers for secured retail lending include the current indexed loan-to-value, previous mortgage arrears, internal cross-product delinquency data and external credit bureau data; for unsecured retail lending they include whether the account is up-to-date and, if not, the number of payments that have been missed; and for wholesale lending they include factors such as observed default rates and loss given default. An assessment is made of the likelihood of each account becoming recognised as impaired within the loss emergence period, with the economic loss that each portfolio is likely to generate were it to become impaired. The loss emergence period is determined by local management for each portfolio and the Group has a range of loss emergence periods which are dependent upon the characteristics of the portfolios. Loss emergence periods are reviewed regularly and updated when appropriate. In general the periods used across the Group vary between one month and twelve months based on historical experience. Unsecured portfolios tend to have shorter loss emergence periods than secured portfolios.

Loan renegotiations and forbearance
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. Renegotiation may lead to the loan and associated provision being derecognised and a new loan being recognised initially at fair value.

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. For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes has been completed, or the status of the account reaches a point where policy dictates that forbearance is no longer appropriate. For wholesale lending, a write-off occurs if the loan facility with the customer is restructured, the asset is under administration and the only monies that can be received are the amounts estimated by the administrator, the underlying assets are disposed and a decision is made that no further settlement monies will be received, or external evidence (for example, third party valuations) is available that there has been an irreversible decline in expected cash flows.

2 Accounting policies (continued)

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 held as available-for-sale. 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 (see (A) above). Any subsequent impairment of the assets or business acquired is treated as an impairment of the relevant asset or business and not as an impairment of the original instrument.

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

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

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

Premises (excluding land):

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

Equipment:

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

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

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

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

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

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

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

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

2 Accounting policies (continued)

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

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

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

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

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

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

m Share-based compensation
Lloyds Banking Group operates a number of equity-settled, share-based compensation plans in respect of services received from certain of its employees. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and in accordance with IFRS 2 (Revised) the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement over any remaining vesting period.

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

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

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

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

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

o Insurance
The Group undertakes both life insurance and general insurance business. Insurance and participating investment contracts are accounted for under IFRS 4 *Insurance Contracts*, which permits (with certain exceptions) the continuation of accounting practices for measuring insurance and participating investment contracts that applied prior to the adoption of IFRS. The Group, therefore, continues to account for these products using UK GAAP, including FRS 27 *Life Assurance*, and UK established practice.

2 Accounting policies (continued)

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

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

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

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

The general insurance business issues only insurance contracts.

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

Liabilities
– Insurance and participating investment contracts in the Group’s with-profit funds
Liabilities of the Group’s with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Financial Services Authority’s realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in the unallocated surplus (see below). Changes in the value of these liabilities are recognised through insurance claims.

– Insurance and participating investment contracts which are not unit-linked or in the Group’s with-profit funds
A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life insurance and annuity benefits where future mortality is uncertain.

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

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

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

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

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

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

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

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

(iii) Value of in-force business
The Group recognises as an asset the value of in-force business in respect of insurance contracts and participating investment contracts. The asset represents the present value of the shareholders’ interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined after making appropriate assumptions about future economic and operating conditions such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow

2 Accounting policies (continued)

in the capital markets. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

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

(2) General insurance business
The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet within liabilities arising from insurance contracts and participating investment contracts and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

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

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

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

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

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

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

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

- The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date.
- The income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions in which case income and expenses are translated at the dates of the transactions.

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

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

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

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

2 Accounting policies (continued)

r Share capital

(1) Share issue costs

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

(2) Dividends

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

s Cash and cash equivalents

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

t Investment in subsidiaries

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

3 Critical accounting estimates and judgements

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

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

Allowance for impairment losses on loans and receivables

At 31 December 2011 gross loans and receivables totalled £648,335 million (2010: £686,047 million) against which impairment allowances of £19,022 million (2010: £18,951 million) had been made (see note 23). The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2h; this note also provides an overview of the methodologies applied.

The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. Impairment allowances are made up of two components, those determined individually and those determined collectively.

Individual impairment allowances are generally established against the Group's wholesale lending portfolios. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer, and the value of the security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in the current economic environment in assessing the borrower's cash flows and debt servicing capability together with the realisable value of real estate collateral. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

Collective impairment allowances are generally established for smaller balance homogenous portfolios such as the Retail portfolios. The collective impairment allowance is also subject to estimation uncertainty and in particular is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is, however, inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

Given the relative size of the mortgage portfolio, a key variable is house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices were ten per cent lower than those estimated at 31 December 2011, the impairment charge would increase by approximately £285 million in respect of UK mortgages and a further £75 million in respect of Irish mortgages.

In addition, a collective unimpaired provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Group's wholesale business, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unimpaired provisions would result in an increase in the collective unimpaired provision of approximately £181 million (at 31 December 2010, a one month increase in the loss emergence period would have increased the collective unimpaired provision by an estimated £333 million).

Unwind of HBOS acquisition fair value adjustments

The acquisition of HBOS in January 2009 required the Lloyds Banking Group to recognise the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. The overall effect was to increase the book value of HBOS's net assets by £1,241 million primarily reflecting a reduction in the value of HBOS's debt securities and subordinated liabilities of £15,439 million, partially offset by a reduction in the carrying value of HBOS's loans and receivables of £14,880 million, including loans and advances to customers of £13,512 million.

In the periods subsequent to the acquisition all of the fair value adjustments unwind. The fair value adjustments made to debt securities and subordinated liabilities unwind over the expected remaining life of the related securities except in the event that the liability is extinguished, in which case the remaining unamortised fair value adjustment is recognised in the income statement immediately. The timing of the unwind of the fair value adjustment relating to loans and receivables requires significant management judgement. This includes the identification of losses which were expected at the date of acquisition and assessing whether anticipated losses will still be incurred. In 2011, there was a benefit of £1,943 million (2010: £3,118 million) to the income statement either from the reversal of a fair value adjustment being credited to the income statement or through a lower impairment charge as a result of the initial HBOS acquisition fair value adjustments.

3 Critical accounting estimates and judgements (continued)

Fair value of financial instruments
In accordance with IFRS 7, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and, in particular, level 3 is determined using valuation techniques including discounted cash flow analysis and valuation models. These valuation techniques involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information.

Valuation techniques for level 2 financial instruments use inputs that are largely based on observable market data. Level 3 financial instruments are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Determining the appropriate assumptions to be used for level 3 financial instruments requires significant management judgement.

At 31 December 2011, the Group classified £6,474 million of financial assets and £790 million of financial liabilities as level 3. Further details of the Group's level 3 financial instruments and the sensitivity of their valuation including the effect of applying reasonably possible alternative assumptions in determining their fair value are set out in note 54.

Recoverability of deferred tax assets
At 31 December 2011, the Group carried deferred tax assets on its balance sheet of £4,565 million (2010: £4,204 million) and deferred tax liabilities of £314 million (2010: £247 million). This presentation takes into account the ability of the Group to net deferred tax assets and liabilities only where there is a legally enforceable right of offset. Note 43 presents the Group's deferred tax assets and liabilities by type. The largest category of deferred tax assets relates to tax losses carried forward.

The recoverability of the Group's deferred tax assets in respect of carry forward losses is based on an assessment of future levels of taxable profit expected to arise that can be offset against these losses. The Group's expectations as to the level of future taxable profits take into account the Group's long-term financial and strategic plans, and anticipated future tax adjusting items.

In making this assessment account is taken of business plans, *the five year board approved operating plan* and the following future risk factors:

– The expected future economic outlook as set out in the Group Chief Executive's Statement contained in the Annual Report of Lloyds Banking Group;
– The retail banking business disposal as required by the European Commission; and
– Future regulatory change.

The Group's total deferred tax asset includes £5,901 million (2010: £6,596 million) in respect of trading losses carried forward. The tax losses have arisen in individual legal entities and will be used as future taxable profits arise in those legal entities, though substantially all of the unused tax losses for which a deferred tax asset has been recognised arise in Bank of Scotland plc and Lloyds TSB Bank plc. The deferred tax asset will be utilised over different time periods in each of the entities in which the tax losses arise. The Group's assessment is that these tax losses will be fully used within eight years.

Under current UK tax law there is no expiry date for unused tax losses.

As disclosed in note 43, deferred tax assets totalling £1,288 million (2010: £685 million) have not been recognised in respect of certain capital losses carried forward, trading losses carried forward (mainly in certain overseas companies) and unrelieved foreign tax credits as there are no predicted future capital or taxable profits against which these losses can be recognised.

Retirement benefit obligations
The net asset recognised in the balance sheet at 31 December 2011 in respect of the Group's retirement benefit obligations was £957 million (comprising an asset of £1,338 million (2010: £736 million) and a liability of £381 million (2010: £423 million) of which an asset of £1,131 million (2010: £479 million) related to defined benefit pension schemes. As explained in note 2, the Group adopts the corridor approach to the recognition of actuarial gains and losses in respect of its pension schemes and as a consequence has not recognised actuarial losses of £539 million (2010: £959 million). After allowing for this, the defined benefit pension schemes' net accounting surplus totalled £592 million (2010: deficit of £480 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

The value of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The accounting surplus or deficit is sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variation. The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience and extrapolate the improving trend, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience.

The effect on the net accounting surplus or deficit and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions are set out in note 42.

Valuation of assets and liabilities arising from life insurance business
At 31 December 2011, the Group recognised a value of in-force business asset of £5,247 million (2010: £5,898 million) and an acquired value of in-force business asset of £1,391 million (2010: £1,469 million). The value of in-force business asset represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. The acquired value of in-force business asset represents the contractual rights to benefits from providing investment management services in relation to non-participating investment contracts acquired in business combinations and portfolio transfers. The methodology used to value these assets is set out in note 2o(1). The valuation or recoverability of these assets requires assumptions to be made about future economic and operating conditions which are inherently uncertain and changes could significantly affect the value attributed to these assets. The key assumptions that have been made in determining the carrying value of the value of in-force business assets at 31 December 2011 are set out in note 28.

At 31 December 2011, the Group carried liabilities arising from insurance contracts and participating investment contracts of £79,001 million (2010: £80,749 million). The methodology used to value these liabilities is described in note 2o(1). Elements of the liability valuations require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour and are subject to significant management judgement and estimation uncertainty. The key assumptions that have been made in determining the carrying value of these liabilities are set out in note 37.

3 Critical accounting estimates and judgements (continued)

The effect on the Group's profit before tax and shareholders' equity of changes in key assumptions used in determining the life insurance assets and liabilities is set out in note 38.

Payment protection insurance
The Group has charged a provision of £3,200 million in respect of payment protection insurance (PPI) policies as a result of discussions with the FSA and a judgment handed down by the UK High Court (see note 44 for more information).

The provision represents management's best estimate of the anticipated costs of related customer contact and/or redress, including administration expenses. However, there are still a number of uncertainties as to the eventual costs from any such contact and/or redress given the inherent difficulties of assessing the impact of detailed implementation of the FSA Policy Statement of 10 August 2010 for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs.

The provision requires significant judgement by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates, Financial Ombudsman Service referral and uphold rates as well as redress costs for each of the many different populations of customers identified by the Group in its analyses used to determine the best estimate of the anticipated costs of redress. If the level of complaints had been one percentage point higher (lower) than estimated for all policies open within the last six years then the provision made in 2011 would have increased (decreased) by approximately £70 million. The reader should note that there are a large number of inter-dependent assumptions under-pinning the provision; the above sensitivity assumes that all assumptions, other than the level of complaints, remain constant. The sensitivity is, therefore, hypothetical and should be used with caution.

The Group will re-evaluate the assumptions underlying its analysis at each reporting date as more information becomes available. As noted above there is inherent uncertainty in making estimates; actual results in future periods may differ from the amount provided.

Provision in relation to German insurance business litigation
Clerical Medical Investment Group Limited (CMIG) has received a number of claims in the German courts relating to policies issued by CMIG but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. CMIG's strategy includes defending claims robustly and appealing against adverse judgments. The ultimate financial effect, which could be significant, will only be known once all relevant claims have been resolved. The Group has charged a provision of £175 million (see note 53 for more information). Management believes this represents the most appropriate estimate of the financial impact, based upon a series of assumptions, including the number of claims received, the proportion upheld, and resulting legal and administration costs.

This provision requires significant judgement by management in determining ap propriate assumptions, including the number of claims received, the proportion upheld, and resulting legal and administration costs. Assuming that all other assumptions remain unchanged, if in the longer term the level of claims was ten percentage points higher (lower) than estimated then the cost would increase (decrease) by approximately £3 million; and if uphold rates were ten percentage points higher (lower) than estimated then the cost would increase (decrease) by approximately £13 million.

The Group will re-evaluate the assumptions underlying its analysis at each reporting date as more information becomes available. As noted above, there is inherent uncertainty in making estimates; actual results in future periods may differ from the amount provided.

4 Segmental analysis

The Lloyds TSB Bank Group provides a wide range of banking and financial services in the UK and in certain locations overseas.

The Group Executive Committee of the Lloyds Banking Group has been determined to be the chief operating decision maker for the Group. The Group's operating segments reflect its organisational and management structures. The Group Executive Committee reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources. This assessment includes a consideration of each segment's net interest revenue and consequently the total interest income and expense for all reportable segments is presented on a net basis. The segments are differentiated by the type of products provided, by whether the customers are individuals or corporate entities and by the geographical location of the customer.

Following the transfer of HBOS to the Group on 1 January 2010, all of the trading activities of the Lloyds Banking Group are carried out within the Group and, as a result, the chief operating decision maker reviews the Group's performance by considering that of the Lloyds Banking Group. The segmental results and comparatives are presented on a combined business basis, the basis reviewed by the chief operating decision maker; during the year ended 31 December 2011 the chief operating decision maker has commenced reviewing the results of the Group's Commercial business separately to the Wholesale segment. As a consequence, the Group's activities are now organised into five financial reporting segments: Retail, Wholesale, Commercial, Wealth and International, and Insurance.

During the third quarter of 2011, the Group implemented a new approach to its allocation methodologies for funding costs and capital that ensures that the cost of funding is more fully reflected in each segment's results. The new methodology is designed to ensure that funding costs are allocated to the segments and that the allocation is more directly related to the size and behavioural duration of asset portfolios, with a similar approach applied to recognise the value to the business from the Group's growing deposit base. Comparative figures have been restated. The impact of this restatement was to reduce net interest income and profit before tax in Retail by £730 million, in Wholesale by £404 million, in Commercial by £48 million and in Wealth and International by £126 million; and to increase net interest income and profit before tax in Insurance by £224 million, in Group Operations by £11 million and in Central by £1,073 million.

Retail offers a broad range of retail financial service products in the UK, including current accounts, savings, personal loans, credit cards and mortgages. It is also a major general insurer and bancassurance distributor, selling a wide range of long-term savings, investment and general insurance products.

The Wholesale division serves businesses with turnover above £15 million with a range of propositions segmented according to customer need. The division comprises Wholesale Banking and Markets, Wholesale Business Support Unit and Asset Finance.

Commercial serves in excess of a million small and medium-sized enterprises and community organisations with a turnover of up to £15 million. Customers extend from start-up enterprises to established corporations, and are supported with a range of propositions aligned to customer needs. Commercial comprises Commercial Banking and Commercial Finance, the invoice discounting and factoring business.

4 Segmental analysis (continued)

Wealth and International was created to give increased focus and momentum to the Lloyds Banking Group's private banking and asset management activities and to closely co-ordinate the management of its international businesses. Wealth comprises the Group's private banking, wealth and asset management businesses in the UK and overseas. International comprises corporate, commercial, asset finance and retail businesses, principally in Australia and Continental Europe.

Insurance provides long-term savings, investment and protection products distributed through the retail branch network, intermediary and direct channels in the UK. It is also a distributor of home insurance in the UK with products sold through the retail branch network, direct channels and strategic corporate partners. The business consists of Life, Pensions and Investments UK, Life, Pensions and Investments Europe, and General Insurance.

Other includes the costs of managing the Group's technology platforms, branch and head office property estate, operations (including payments, banking operations and collections) and procurement services, the costs of which are predominantly recharged to the other divisions. It also reflects other items not recharged to the divisions, including hedge ineffectiveness, UK bank levy, Financial Services Compensation Scheme costs, gains on liability mangement, volatile items such as hedge accounting volatility managed centrally and other gains from the structural hedging of interest rate risk.

Inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

For the majority of those derivative contracts entered into by business units for risk management purposes, the business unit recognises the net interest income or expense on an accrual accounting basis and transfers the remainder of the fair value of the swap to the central group segment where the resulting accounting volatility is managed where possible through the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the swap and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results and records volatility in the central group segment where it is managed.

2011	Retail £m	Wholesale £m	Commercial £m	Wealth and International £m	Insurance £m	Group Operations and Central items £m	Reported basis total £m
Net interest income	7,497	2,139	1,251	828	(67)	585	12,233
Other income	1,649	3,335	446	1,197	2,687	(7)	9,307
Effects of liability management, volatile items and asset sales	48	(1,415)	–	–	–	1,293	(74)
Total income	9,194	4,059	1,697	2,025	2,620	1,871	21,466
Insurance claims	–	–	–	–	(343)	–	(343)
Total income, net of insurance claims	9,194	4,059	1,697	2,025	2,277	1,871	21,123
Operating expenses	(4,438)	(2,518)	(948)	(1,548)	(812)	(357)	(10,621)
Trading surplus	4,756	1,541	749	477	1,465	1,514	10,502
Impairment	(1,970)	(2,901)	(303)	(4,610)	–	(3)	(9,787)
Share of results of joint ventures and associates	11	14	–	3	–	(1)	27
Profit (loss) before tax and fair value unwind	2,797	(1,346)	446	(4,130)	1,465	1,510	742
Fair value unwind	839	2,174	53	194	(43)	(1,274)	1,943
Profit (loss) before tax	3,636	828	499	(3,936)	1,422	236	2,685

2011	Retail £m	Wholesale £m	Commercial £m	Wealth and International £m	Insurance £m	Other £m	Reported basis total £m
External revenue	12,267	2,895	1,263	2,144	3,253	(356)	21,466
Inter-segment revenue	(3,073)	1,164	434	(119)	(633)	2,227	–
Segment revenue	9,194	4,059	1,697	2,025	2,620	1,871	21,466
Segment external assets	356,295	320,435	28,998	74,623	140,754	49,441	970,546
Segment customer deposits	247,088	91,357	32,107	42,019	–	1,335	413,906
Segment external liabilities	279,162	259,209	32,723	75,791	129,350	147,717	923,952
Other segment items reflected in income statement above:							
Depreciation and amortisation	364	967	53	60	91	67	1,602
Increase (decrease) in value of in-force business	–	–	–	3	(625)	–	(622)
Defined benefit scheme charges	121	33	33	25	23	(36)	199
Other segment items:							
Additions to tangible fixed assets	189	1,435	2	212	451	806	3,095
Investments in joint ventures and associates at end of year	147	80	–	104	–	3	334

4 Segmental analysis (continued)

2010	Retail £m	Wholesale £m	Commercial £m	Wealth and International £m	Insurance £m	Group Operations and Central items £m	Reported basis total £m
Net interest income	8,648	2,847	1,127	1,050	(39)	510	14,143
Other income	1,607	3,974	457	1,123	2,799	(24)	9,936
Effects of liability management, volatile items and asset sales	–	(295)	–	37	15	150	(93)
Total income	10,255	6,526	1,584	2,210	2,775	636	23,986
Insurance claims	–	–	–	–	(542)	–	(542)
Total income, net of insurance claims	10,255	6,526	1,584	2,210	2,233	636	23,444
Operating expenses	(4,644)	(2,902)	(992)	(1,536)	(854)	(150)	(11,078)
Trading surplus	5,611	3,624	592	674	1,379	486	12,366
Impairment	(2,747)	(4,064)	(382)	(5,988)	–	–	(13,181)
Share of results of joint ventures and associates	17	(95)	–	(8)	(10)	5	(91)
Profit (loss) before tax and fair value unwind	2,881	(535)	210	(5,322)	1,369	491	(906)
Fair value unwind	1,105	3,049	81	372	(43)	(1,446)	3,118
Profit (loss) before tax	3,986	2,514	291	(4,950)	1,326	(955)	2,212

2010	Retail £m	Wholesale £m	Commercial £m	Wealth and International £m	Insurance £m	Other £m	Reported basis total £m
External revenue	13,603	3,911	1,378	3,000	3,180	(1,086)	23,986
Inter-segment revenue	(3,348)	2,615	206	(790)	(405)	1,722	–
Segment revenue	10,255	6,526	1,584	2,210	2,775	636	23,986
Segment external assets[1]	369,170	327,055	28,938	85,508	143,300	37,603	991,574
Segment customer deposits	235,591	92,951	31,311	32,784	–	996	393,633
Segment external liabilities	275,945	289,257	31,952	65,658	132,133	149,727	944,672
Other segment items reflected in income statement above:							
Depreciation and amortisation	384	1,071	62	87	135	64	1,803
Movement in value of in-force business	–	–	–	2	787	–	789
Defined benefit scheme charges	176	52	37	36	28	126	455
Other segment items:							
Additions to tangible fixed assets	126	1,703	5	20	585	777	3,216
Investments in joint ventures and associates at end of year	139	127	–	158	–	5	429

[1]Segment external assets as at 31 December 2010 have been restated to reflect the reclassification of certain central adjustments.

4 Segmental analysis (continued)

2011	Lloyds TSB Bank Group statutory £m	Impact of other entities in the Lloyds Banking Group[1] £m	Removal of: Acquisition related and other items[2] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Legal and regulatory provisions[3]	Fair value unwind £m	Reported basis £m
Net interest income	**12,856**	**(158)**	**(820)**	**(19)**	**(336)**	**–**	**710**	**12,233**
Other income	**15,739**	**(1,625)**	**894**	**857**	**(5,530)**	**–**	**(1,028)**	**9,307**
Liability management gains	**–**	**–**	**(74)**	**–**	**–**	**–**	**–**	**(74)**
Total income	**28,595**	**(1,783)**	**–**	**838**	**(5,866)**	**–**	**(318)**	**21,466**
Insurance claims	**(6,041)**	**–**	**–**	**–**	**5,698**	**–**	**–**	**(343)**
Total income, net of insurance claims	**22,554**	**(1,783)**	**–**	**838**	**(168)**	**–**	**(318)**	**21,123**
Operating expenses	**(16,022)**	**(228)**	**2,014**	**–**	**168**	**3,375**	**72**	**(10,621)**
Trading surplus	**6,532**	**(2,011)**	**2,014**	**838**	**–**	**3,375**	**(246)**	**10,502**
Impairment	**(8,094)**	**–**	**–**	**–**	**–**	**–**	**(1,693)**	**(9,787)**
Share of results of joint ventures and associates	**31**	**–**	**–**	**–**	**–**	**–**	**(4)**	**27**
Loss on disposal of businesses	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Fair value unwind	**–**	**–**	**–**	**–**	**–**	**–**	**1,943**	**1,943**
(Loss) profit before tax	**(1,531)**	**(2,011)**	**2,014**	**838**	**–**	**3,375**	**–**	**2,685**

[1] This reflects the inclusion in the results reviewed by the chief operating decision maker of the Bank's fellow subsidiary undertakings and its parent undertaking, Lloyds Banking Group plc.

[2] Comprises integration and simplification costs related to severance, IT and business costs of implementation (£1,282 million), EC mandated retail business disposal costs (£170 million), amortisation of purchased intangibles (£562 million) and the effects of liability management, volatile items and asset sales (£74 million).

[3] Comprises the payment protection insurance provision (£3,200 million) and the provision in relation to German insurance business litigation (£175 million).

2010	Lloyds TSB Bank Group statutory £m	Impact of other entities in the Lloyds Banking Group[1] £m	Removal of: Acquisition related and other items[2] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Customer goodwill payments provision and loss on disposal of businesses £m	Fair value unwind £m	Reported basis £m
Net interest income	12,686	(140)	321	26	949	–	301	14,143
Other income	31,768	(270)	(228)	(332)	(19,739)	–	(1,263)	9,936
Liability management gain	–	–	(93)	–	–	–	–	(93)
Total income	44,454	(410)	–	(306)	(18,790)	–	(962)	23,986
Insurance claims	(19,088)	–	–	–	18,544	–	2	(542)
Total income, net of insurance claims	25,366	(410)	–	(306)	(246)	–	(960)	23,444
Costs:								
Operating expenses	(13,034)	(34)	1,320	–	246	500	74	(10,928)
Impairment of tangible fixed assets	(202)	–	52	–	–	–	–	(150)
	(13,236)	(34)	1,372	–	246	500	74	(11,078)
Trading surplus	12,130	(444)	1,372	(306)	–	500	(886)	12,366
Impairment	(10,952)	–	–	–	–	–	(2,229)	(13,181)
Share of results of joint ventures and associates	(88)	–	–	–	–	–	(3)	(91)
Loss on disposal of businesses	(365)	–	–	–	–	365	–	–
Fair value unwind	–	–	–	–	–	–	3,118	3,118
Profit (loss) before tax	725	(444)	1,372	(306)	–	865	–	2,212

[1] This reflects the inclusion in the results reviewed by the chief operating decision maker of the Bank's fellow subsidiary undertakings and its parent undertaking, Lloyds Banking Group plc.

[2] Comprises the pension curtailment gain (£910 million), integration costs (£1,653 million) the amortisation of purchased intangibles (£629 million) and the effects of liability management , volatile items and asset sales (£93 million).

4 Segmental analysis (continued)

Geographical areas

The Group's activities are focused in the UK and the analyses of income and assets below are based on the location of the branch or entity recording the income or assets.

	2011			2010		
	UK £m	**Non-UK £m**	**Total £m**	UK £m	Non-UK £m	Total £m
Total income	**26,175**	**2,420**	**28,595**	40,255	4,199	44,454
Total assets	**893,738**	**94,628**	**988,366**	890,825	117,907	1,008,732

There was no individual non-UK country contributing more than 5 per cent of total income or total assets.

5 Net interest income

	Weighted average effective interest rate			
	2011 %	2010[1] %	**2011 £m**	2010 £m
Interest and similar income:				
Loans and advances to customers, excluding lease and hire purchase receivables	**3.92**	4.24	**23,409**	25,459
Loans and advances to banks	**0.78**	1.20	**628**	851
Debt securities held as loans and receivables	**3.17**	4.43	**590**	1,396
Lease and hire purchase receivables	**5.13**	6.74	**742**	626
Interest receivable on loans and receivables	**3.56**	3.98	**25,369**	28,332
Available-for-sale financial assets	**2.98**	2.84	**1,058**	1,295
Held-to-maturity investments	**3.29**	2.51	**262**	55
Total interest and similar income	**3.53**	3.91	**26,689**	29,682
Interest and similar expense:				
Deposits from banks, excluding liabilities under sale and repurchase agreements	**0.80**	2.30	**(222)**	(943)
Customer deposits, excluding liabilities under sale and repurchase agreements	**1.79**	1.47	**(6,880)**	(5,359)
Debt securities in issue	**2.21**	2.49	**(5,007)**	(5,835)
Subordinated liabilities	**5.84**	10.54	**(1,608)**	(3,217)
Liabilities under sale and repurchase agreements	**1.39**	1.18	**(335)**	(744)
Interest payable on liabilities held at amortised cost	**2.03**	2.19	**(14,052)**	(16,098)
Other	**(1.14)**	6.97	**219**	(898)
Total interest and similar expense	**1.95**	2.28	**(13,833)**	(16,996)
Net interest income			**12,856**	12,686

[1] During 2011 the Group has revised its treatment of offset accounts; average balances for 2010 have been restated accordingly.

Included within interest and similar income is £1,405 million (2010: £1,288 million) in respect of impaired financial assets. Net interest income also includes a charge of £70 million (2010: £932 million) transferred from the cash flow hedging reserve (see note 48).

6 Net fee and commission income

	2011 £m	2010 £m
Fee and commission income:		
Current accounts	**1,053**	1,086
Credit and debit card fees	**877**	812
Other[1]	**3,005**	3,094
Total fee and commission income	**4,935**	4,992
Fee and commission expense	**(1,391)**	(1,682)
Net fee and commission income	**3,544**	3,310

As discussed in note 2(d), fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 5. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 7.

[1] In previous years the Group has included annual management charges on non-participating investment contracts within insurance claims. In light of developing industry practice, these amounts (2011: £606 million; 2010: £577 million) are now included within net fee and commission income.

7 Net trading income

	2011 £m	2010 £m
Foreign exchange translation gains	**317**	29
Gains on foreign exchange trading transactions	**342**	359
Total foreign exchange	**659**	388
Investment property (losses) gains (note 26)	**(107)**	434
Securities and other (losses) gains (see below)	**(1,377)**	15,345
Net trading income	**(825)**	16,167

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

	2011 £m	2010 £m
Net income (expense) arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**5,292**	2,286
Equity shares	**(4,917)**	10,333
Total net income arising on assets held at fair value through profit or loss	**375**	12,619
Net expense arising on liabilities held at fair value through profit or loss – debt securities in issue	**(233)**	(216)
Total net gains arising on assets and liabilities held at fair value through profit or loss	**142**	12,403
Net (losses) gains on financial instruments held for trading	**(1,519)**	2,942
Securities and other (losses) gains	**(1,377)**	15,345

8 Insurance premium income

	2011 £m	2010 £m
Life insurance		
Gross premiums	**7,276**	7,026
Ceded reinsurance premiums	**(322)**	(253)
Net earned premiums	**6,954**	6,773
Non-life insurance		
Gross premiums written	**1,198**	1,332
Ceded reinsurance premiums	**(52)**	(104)
Net written premiums	**1,146**	1,228
Change in provision for unearned premiums (note 37(2))	**70**	156
Change in provision for ceded unearned premiums (note 37(2))	**–**	(9)
Net earned premiums	**1,216**	1,375
Total net earned premiums	**8,170**	8,148

Life insurance gross premiums can be further analysed as follows:

	2011 £m	2010 £m
Life and pensions	**6,737**	6,428
Annuities	**529**	583
Other	**10**	15
Gross premiums	**7,276**	7,026

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

	2011 £m	2010 £m
Credit protection	**231**	363
Home	**963**	964
Health	**4**	5
Gross written premiums	**1,198**	1,332

9 Other operating income

	2011 £m	2010 £m
Operating lease rental income	**1,268**	1,410
Rental income from investment properties (note 26)	**388**	337
Other rents receivable	**34**	41
Gains less losses on disposal of available-for-sale financial assets (note 48)	**343**	399
Movement in value of in-force business (note 28)	**(622)**	789
Liability management gains	**2,682**	352
Other income	**757**	815
Total other operating income	**4,850**	4,143

Liability management gains

During December 2011, the Lloyds Banking Group completed the exchange of certain subordinated debt securities issued by the Bank and HBOS plc for new subordinated debt securities issued by the Bank by undertaking an exchange offer on certain securities which were eligible for call before 31 December 2012. This exchange resulted in a gain on extinguishment of the existing securities of £599 million being the difference between the carrying amount of the securities extinguished and the fair value of the new securities issued together with related fees and costs.

As part of the exchange, the Lloyds Banking Group announced that all decisions to exercise calls on those original securities that remained outstanding following the exchange offer would be made with reference to the prevailing regulatory, economic and market conditions at the time. These securities will not, therefore, be called at their first available call date which will lead to coupons continuing to be being paid until possibly the final redemption date of the securities. Consequently, the Group is required to adjust the carrying amount of these securities to reflect the revised estimated cash flows over their revised life and to recognise this change in carrying value in interest expense. Included within net interest income is a credit of £570 million in respect of the securities that remained outstanding following the exchange offer. In December 2011, the Lloyds Banking Group decided to defer payment of non-mandatory coupons on certain securities and, instead, settle them using an Alternative Coupon Satisfaction Mechanism on their contractual terms. This change in expected cashflows resulted in a gain of £126 million in net interest income from the recalculation of the carrying value of these securities.

In addition, the Lloyds Banking Group restructured certain securities issued by the Bank and held by fellow Lloyds banking Group undertakings; this lead to a profit of £2,083 million recognised by the Group.

During 2010, as part of the Lloyds Banking Group's management of capital, the Group exchanged certain existing subordinated debt securities for new securities and ordinary shares. These exchanges resulted in a gain on extinguishment of the existing liabilities of £352 million in the year ended 31 December 2010.

10 Insurance claims

Insurance claims comprise:

	2011 £m	2010 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross	**(8,622)**	(9,397)
Reinsurers' share	**230**	159
	(8,392)	(9,238)
Change in insurance and participating investment contract liabilities (note 37(1)):		
Change in gross liabilities	**1,383**	(4,622)
Change in reinsurers' share of liabilities	**451**	256
	1,834	(4,366)
Change in non-participating investment contract liabilities:		
Change in gross liabilities[1]	**527**	(5,449)
Change in reinsurers' share of liabilities	**–**	65
	527	(5,384)
Change in unallocated surplus (note 40)	**340**	439
Total life insurance and participating investment contracts	**(5,691)**	(18,549)

10 Insurance claims (continued)

	2011 £m	2010 £m
Non-life insurance		
Claims and claims paid:		
Gross	**(528)**	(470)
Reinsurers' share	**4**	11
	(524)	(459)
Change in liabilities (note 37(2)):		
Gross	**186**	(82)
Reinsurers' share	**(12)**	2
	174	(80)
Total non-life insurance	**(350)**	(539)
Total insurance claims expense	**(6,041)**	(19,088)

Life insurance and participating investment contracts gross claims can also be analysed as follows:

	2011 £m	2010 £m
Deaths	**(625)**	(662)
Maturities	**(1,861)**	(1,763)
Surrenders	**(5,041)**	(5,904)
Annuities	**(764)**	(741)
Other	**(331)**	(327)
Total life insurance gross claims	**(8,622)**	(9,397)

[1]In previous years the Group has included annual management charges on non-participating investment contracts within insurance claims. In light of developing industry practice, these amounts (2011: £606 million; 2010: £577 million; 2009: £474 million) are now included within net fee and commission income.

A non-life insurance claims development table is included in note 37.

11 Operating expenses

	2011 £m	2010[1] £m
Staff costs:		
Salaries	**3,774**	3,787
Performance-based compensation	**371**	533
Social security costs	**432**	396
Pensions and other post-retirement benefit schemes (note 42):		
Curtailment gain[2]	**–**	(910)
Other	**401**	628
	401	(282)
Restructuring costs	**124**	119
Other staff costs	**1,064**	1,069
	6,166	5,622
Premises and equipment:		
Rent and rates	**547**	602
Hire of equipment	**22**	18
Repairs and maintenance	**188**	199
Other	**294**	358
	1,051	1,177
Other expenses:		
Communications and data processing	**954**	1,126
Advertising and promotion	**398**	362
Professional fees	**575**	742
Customer goodwill payments provision (note 44)	**–**	500
Financial services compensation scheme management expenses levy (note 53)	**179**	46
Provision in relation to German insurance business litigation (note 44)	**175**	–
Other	**1,084**	1,027
	3,365	3,803

11 Operating expenses (continued)

	2011 £m	2010 £m
Depreciation and amortisation:		
Depreciation of tangible fixed assets (note 30)	1,434	1,635
Amortisation of acquired value of in-force non-participating investment contracts (note 28)	78	76
Amortisation of other intangible assets (note 29)	663	721
	2,175	2,432
Impairment of tangible fixed assets (note 30)	65	202
Total operating expenses, excluding payment protection insurance provision	12,822	13,236
Payment protection insurance provision (note 44)	3,200	–
Total operating expenses	16,022	13,236

[1]During 2011, the Group has reviewed the analysis of certain cost items and as a result has reclassified some items of expenditure; comparatives for 2010 have been restated accordingly.

[2]During the year ended 31 December 2010, following changes by the Group to the terms of its defined benefit pension schemes, all future increases to pensionable salary will be capped each year at the lower of: Retail Prices Index inflation; each employee's actual percentage increase in pay; and 2 per cent of pensionable pay. In addition to this, during the second half of 2010 there was a change in commutation factors in certain defined benefit schemes. The combined effect of these changes was a reduction in the Group's defined benefit obligation in 2010 of £1,081 million and a reduction in the Group's actuarial losses of £171 million, resulting in a net curtailment gain of £910 million recognised in the income statement and a reduction in the balance sheet liability.

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

	2011	2010
UK	116,371	118,149
Overseas	4,078	4,830
Total	120,449	122,979

Fees payable to the Bank's auditors

During the year the auditors earned the following fees:

	2011 £m	2010 £m
Fees payable for the audit of the Bank's current year annual report	4.6	6.3
Fees payable for other services:		
Audit of the Bank's subsidiaries pursuant to legislation	12.3	11.6
Other services supplied pursuant to legislation	1.8	1.3
Other services – audit-related fees	2.1	0.5
Other services relating to taxation	1.1	1.0
Services relating to corporate finance transactions	0.7	0.3
All other services	2.2	0.8
Total fees payable to the Bank's auditors	24.8	21.8

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

	2011 £m	2010 £m
Audits of the Group pension schemes	0.4	0.3
Audits of unconsolidated Open Ended Investment Companies managed by the Group	0.6	0.8
Reviews of the financial position of corporate and other borrowers	11.0	17.2
Acquisition due diligence and other work performed in respect of potential venture capital investments	1.0	1.2

12 Impairment

	2011 £m	2010 £m
Impairment losses on loans and receivables (note 23):		
Loans and advances to banks	–	(13)
Loans and advances to customers	8,020	10,727
Debt securities classified as loans and receivables	49	57
Total impairment losses on loans and receivables	8,069	10,771
Impairment of available-for-sale financial assets	80	106
Other credit risk provisions (note 44)	(55)	75
Total impairment charged to the income statement	8,094	10,952

13 Investments in joint ventures and associates

The Group's share of results of and investments in joint ventures and associates comprises:

	Joint ventures		Associates		Total	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Share of income statement amounts:						
Income	**316**	318	**160**	135	**476**	453
Expenses	**(261)**	(209)	**(161)**	(91)	**(422)**	(300)
Impairment	**(20)**	(126)	**1**	(92)	**(19)**	(218)
Profit (loss) before tax	**35**	(17)	**–**	(48)	**35**	(65)
Tax	**(4)**	(22)	**–**	(1)	**(4)**	(23)
Share of post-tax results	**31**	(39)	**–**	(49)	**31**	(88)
Share of balance sheet amounts:						
Current assets	**3,346**	3,370	**246**	378	**3,592**	3,748
Non-current assets	**2,148**	2,868	**976**	1,183	**3,124**	4,051
Current liabilities	**(714)**	(588)	**(293)**	(433)	**(1,007)**	(1,021)
Non-current liabilities	**(4,471)**	(5,324)	**(904)**	(1,025)	**(5,375)**	(6,349)
Share of net assets at 31 December	**309**	326	**25**	103	**334**	429
Movement in investments over the year:						
At 1 January	**326**	54	**103**	2	**429**	56
Adjustment on transfer of HBOS (note 31)	**–**	316	**–**	107	**–**	423
Additional investments	**7**	71	**3**	6	**10**	77
Disposals	**(47)**	(68)	**(79)**	(2)	**(126)**	(70)
Share of post-tax results	**31**	(39)	**–**	(49)	**31**	(88)
Dividends paid	**(5)**	–	**(1)**	(1)	**(6)**	(1)
Exchange and other adjustments	**(3)**	(8)	**(1)**	40	**(4)**	32
Share of net assets at 31 December	**309**	326	**25**	103	**334**	429

During 2011, the Group recognised a net £8 million of losses of associates not previously recognised. The Group's unrecognised share of losses of associates during 2010 was £8 million and of joint ventures is £85 million in 2011 (2010: £180 million). For entities making losses, subsequent profits earned are not recognised until previously unrecognised losses are extinguished. The Group's unrecognised share of losses net of unrecognised profits on a cumulative basis of associates is £56 million (2010: £104 million) and of joint ventures is £299 million (2010: £339 million).

The Group's principal joint venture investment at 31 December 2011 was in Sainsbury's Bank plc; the Group owns 50 per cent of the ordinary share capital of Sainsbury's Bank plc, whose business is banking and principal area of operation is the UK. Sainsbury's Bank plc is incorporated in the UK and the Group's interest is held by a subsidiary.

Where entities have statutory accounts drawn up to a date other than 31 December management accounts are used when accounting for them by the Group.

14 Loss on disposal of businesses in 2010

During 2009, the Group acquired an oil drilling rig construction business through a previous lending relationship and consolidated the results and net assets of the business from the date it exercised control.

In the first half of 2010, as a result of a deteriorating market, the Group impaired the oil drilling rigs under construction held by the business by £150 million to reflect their reduced value in use. This impairment was recognised in the Wholesale segment.

In the second half of 2010, the Group reached agreement to dispose of its interests in the two wholly-owned subsidiary companies through which this business operates; the sale was completed in January 2011. These companies, which had gross assets of £860 million, were sold to Seadrill Limited; a loss of £365 million arose on disposal.

The Group extended vendor financing, on normal commercial terms and negotiated on an arms length basis, to Seadrill to facilitate the acquisition of the rig holding companies. The loan is not contingent on the peformance of the oil rigs under construction. Accordingly, as at 31 December 2010, the subsidiaries were derecognised.

15 Taxation

a Analysis of tax credit (charge) for the year

	2011 £m	2010 £m
UK corporation tax:		
Current tax on profit or loss for the year	**(174)**	(243)
Adjustments in respect of prior years	**(152)**	315
	(326)	72
Double taxation relief	**–**	1
	(326)	73
Foreign tax:		
Current tax on profit for the year	**(90)**	(82)
Adjustments in respect of prior years	**36**	49
	(54)	(33)
Current tax (charge) credit	**(380)**	40
Deferred tax (note 43):		
Origination and reversal of temporary differences	**1,646**	(555)
Reduction in UK corporation tax rate	**(411)**	(142)
Adjustments in respect of prior years	**(119)**	(161)
	1,116	(858)
Tax credit (charge)	**736**	(818)

The credit (charge) for tax on the profit for 2011 and 2010 is based on a UK corporation tax rate of 26.5 per cent (2010: 28.0 per cent).

The above income tax credit (charge) is made up as follows:

	2011 £m	2010 £m
Tax credit (charge) attributable to policyholders	**72**	(315)
Shareholder tax credit (charge)	**664**	(503)
Tax credit (charge)	**736**	(818)

b Factors affecting the tax credit (charge) for the year

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

	2011 £m	2010 £m
(Loss) profit before tax	**(1,531)**	725
Tax credit (charge) thereon at UK corporation tax rate of 26.5 per cent (2010: 28.0 per cent)	**406**	(203)
Factors affecting credit (charge):		
UK corporation tax rate change	**(411)**	(142)
Disallowed and non-taxable items	**829**	(25)
Overseas tax rate differences	**17**	134
Gains exempted or covered by capital losses	**14**	65
Policyholder interests	**53**	(227)
Tax losses surrendered for no payment	**–**	(123)
Deferred tax on losses not previously recognised	**332**	–
Tax losses where no deferred tax recognised	**(261)**	(478)
Adjustments in respect of previous years	**(235)**	203
Effect of profit in joint ventures and associates	**8**	(25)
Other items	**(16)**	3
Tax credit (charge) on (loss) profit on ordinary activities	**736**	(818)

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Trading assets	**18,068**	23,743	**4,084**	3,526
Other financial assets at fair value through profit or loss	**121,175**	132,533	**581**	1,061
Total	**139,243**	156,276	**4,665**	4,587

These assets are comprised as follows:

	2011		2010		**2011**		2010	
	Trading assets £m	**Other financial assets at fair value through profit or loss £m**	Trading assets £m	Other financial assets at fair value through profit or loss £m	**Trading assets £m**	**Other financial assets at fair value through profit or loss £m**	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to customers	**9,642**	**124**	9,486	325	**–**	**69**	–	325
Loans and advances to banks	**1,355**	**–**	2,734	–	**–**	**–**	–	–
Debt securities:								
Government securities	**2,000**	**21,367**	1,623	22,217	**1,008**	**–**	220	13
Other public sector securities	**–**	**1,183**	–	919	**–**	**–**	–	–
Bank and building society certificates of deposit	**2,863**	**385**	3,692	606	**1,479**	**–**	–	–
Asset-backed securities:								
Mortgage-backed securities	**99**	**612**	–	422	**99**	**–**	–	–
Other asset-backed securities	**222**	**1,764**	1,020	1,592	**19**	**–**	47	47
Corporate and other debt securities	**1,588**	**19,981**	4,955	16,190	**1,404**	**496**	3,259	647
	6,772	**45,292**	11,290	41,946	**4,009**	**496**	3,526	707
Equity shares	**–**	**75,759**	6	90,262	**–**	**16**	–	29
Treasury bills and other bills	**299**	**–**	227	–	**75**	**–**	–	–
Total	**18,068**	**121,175**	23,743	132,533	**4,084**	**581**	3,526	1,061

At 31 December 2011 £119,025 million (2010: £129,792 million) of trading and other financial assets at fair value through profit or loss of the Group and £2,688 million (2010: £2,426 million) of the Bank had a contractual residual maturity of greater than one year.

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

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

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

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

The maximum exposure to credit risk at 31 December 2011 of the loans and advances to customers designated at fair value through profit or loss by the Bank and the Group was £124 million (2010: £325 million); the Bank and the Group do not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk; this is determined by reference to the publicly available credit ratings of the instruments involved.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £10,990 million for the Group (2010: £12,211 million). Collateral is held with a fair value of £15,765 million for the Group (2010: £14,299 million), all of which the Group is able to repledge. At 31 December 2011, £3,740 million had been repledged by the Group (2010: £3,161 million).

For amounts included above which are subject to repurchase agreements see note 54.

17 Derivative financial instruments

The Group holds derivatives as part of the following strategies:

– Customer driven, where derivatives are held as part of the provision of risk management products to Group customers;
– To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value, cash flow and net investment hedge approaches as described in note 55;
– Derivatives held in policyholders funds as permitted by the investment strategies of those funds.

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS39. Derivatives are held at fair value on the Group's balance sheet. A description of the methodology used to determine the fair value of derivative financial instruments and the effect of using reasonably possible alternative assumptions for those derivatives valued using unobservable inputs is set out in note 54.

The principal derivatives used by the Group are as follows:

– Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.
– Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.
– Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. The Group also uses credit default swaps to securitise, in combination with external funding, £3,436 million (2010: £4,149 million) of corporate and commercial banking loans.
– Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date.

The fair values and notional amounts of derivative instruments are set out in the following table:

	2011			2010		
The Group	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**178,312**	**2,542**	**2,780**	212,832	2,513	2,242
Currency swaps	**97,926**	**3,499**	**2,208**	108,681	5,696	1,958
Options purchased	**17,725**	**610**	**–**	18,096	602	–
Options written	**18,654**	**–**	**616**	19,387	–	536
	312,617	**6,651**	**5,604**	358,996	8,811	4,736
Interest rate contracts:						
Interest rate swaps	**927,668**	**38,806**	**40,207**	1,399,197	28,448	29,504
Forward rate agreements	**238,327**	**586**	**613**	718,227	309	297
Options purchased	**62,713**	**3,693**	**–**	59,578	2,371	–
Options written	**58,898**	**–**	**3,517**	60,828	–	2,170
Futures	**118,921**	**1**	**2**	23,361	3	1
	1,406,527	**43,086**	**44,339**	2,261,191	31,131	31,972
Credit derivatives	**9,980**	**238**	**328**	7,108	256	207
Equity and other contracts	**18,209**	**2,018**	**1,184**	22,596	1,996	1,332
Total derivative assets/liabilities held for trading	**1,747,333**	**51,993**	**51,455**	2,649,891	42,194	38,247
Hedging						
Derivatives designated as fair value hedges:						
Cross currency swaps	**12,317**	**708**	**302**	9,418	606	35
Interest rate swaps (including swap options)	**110,943**	**6,719**	**1,236**	75,831	4,366	1,200
Options written	**879**	**–**	**9**	–	–	–
Derivatives designated as cash flow hedges:						
Cross currency swaps	**7,432**	**172**	**90**	17,745	232	121
Interest rate swaps	**207,343**	**5,250**	**5,608**	112,507	2,199	3,042
Futures	**103,467**	**–**	**–**	1,299	1	–
Derivatives designated as net investment hedges:						
Cross currency swaps	**49**	**–**	**1**	86	2	–
Total derivative assets/liabilities held for hedging	**442,430**	**12,849**	**7,246**	216,886	7,406	4,398
Total recognised derivative assets/liabilities	**2,189,763**	**64,842**	**58,701**	2,866,777	49,600	42,645

17 Derivative financial instruments (continued)

Hedged cash flows

For designated cash flow hedges the following table shows when the Group's hedged cash flows are expected to occur and when they will affect income.

2011	**0-1 years £m**	**1-2 years £m**	**2-3 years £m**	**3-4 years £m**	**4-5 years £m**	**5-10 years £m**	**10-20 years £m**	**Over 20 years £m**	**Total £m**
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**140**	**239**	**475**	**208**	**35**	**354**	**192**	**66**	**1,709**
Forecast payable cash flows	**(178)**	**(181)**	**(63)**	**(81)**	**(78)**	**(1,394)**	**(1,163)**	**(354)**	**(3,492)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**234**	**232**	**389**	**208**	**47**	**383**	**162**	**54**	**1,709**
Forecast payable cash flows	**(224)**	**(154)**	**(53)**	**(81)**	**(145)**	**(1,475)**	**(1,110)**	**(250)**	**(3,492)**

2010	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	76	246	427	478	373	329	131	143	2,203
Forecast payable cash flows	(85)	(34)	(137)	(82)	(58)	(175)	(286)	(57)	(914)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	76	287	387	478	373	345	136	121	2,203
Forecast payable cash flows	(85)	(79)	(92)	(82)	(58)	(244)	(248)	(26)	(914)

There were no transactions for which cash flow hedge accounting had to be ceased in 2011 or 2010 as a result of the highly probable cash flows no longer being expected to occur.

At 31 December 2011 £58,269 million of total recognised derivative assets of the Group and £52,020 million of total recognised derivative liabilities of the Group (2010: £42,303 million of assets and £36,059 million of liabilities) had a contractual residual maturity of greater than one year.

	2011			2010		
The Bank	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**207,436**	**2,492**	**2,885**	218,976	2,459	2,286
Currency swaps	**105,038**	**2,449**	**1,914**	60,551	1,903	1,343
Options purchased	**18,214**	**615**	**–**	18,228	601	–
Options written	**19,051**	**–**	**619**	19,435	–	539
	349,739	**5,556**	**5,418**	317,190	4,963	4,168
Interest rate contracts:						
Interest rate swaps	**1,401,283**	**25,124**	**24,483**	788,077	12,593	12,887
Forward rate agreements	**62,196**	**514**	**546**	12,872	83	84
Options purchased	**59,448**	**3,026**	**–**	46,624	1,933	–
Options written	**59,378**	**–**	**2,952**	40,665	–	1,626
Futures	**5,630**	**1**	**1**	1,883	–	–
	1,587,935	**28,665**	**27,982**	890,121	14,609	14,597
Credit derivatives	**10,105**	**228**	**254**	5,749	205	228
Equity and other contracts	**11,842**	**473**	**472**	9,970	589	589
Total derivative assets/liabilities held for trading	**1,959,621**	**34,922**	**34,126**	1,223,030	20,366	19,582
Hedging						
Derivatives designated as fair value hedges:						
Cross currency swaps	**29**	**216**	**186**	–	–	–
Interest rate swaps (including swap options)	**53,808**	**2,379**	**692**	30,777	927	589
Options written	**657**	**–**	**9**	–	–	–
Derivatives designated as cash flow hedges:						
Interest rate swaps	**1,075**	**–**	**18**	1,597	29	89
Total derivative assets/liabilities held for hedging	**55,569**	**2,595**	**905**	32,374	956	678
Total recognised derivative assets/liabilities	**2,015,190**	**37,517**	**35,031**	1,255,404	21,322	20,260

17 Derivative financial instruments (continued)

Hedged cash flows
For designated cash flow hedges the following table shows when the Bank's hedged cash flows are expected to occur and when they will affect income.

2011	**0-1 years £m**	**1-2 years £m**	**2-3 years £m**	**3-4 years £m**	**4-5 years £m**	**5-10 years £m**	**10-20 years £m**	**Over 20 years £m**	**Total £m**
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**49**	**48**	**28**	**1**	**1**	**6**	**–**	**–**	**133**
Forecast payable cash flows	**(50)**	**(7)**	**(1)**	**(49)**	**(29)**	**(2)**	**(2)**	**–**	**(140)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**49**	**48**	**28**	**1**	**1**	**6**	**–**	**–**	**133**
Forecast payable cash flows	**(50)**	**(7)**	**(1)**	**(49)**	**(29)**	**(2)**	**(2)**	**–**	**(140)**

2010	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast payable cash flows	(5)	(6)	(11)	(16)	(22)	(139)	–	–	(199)
Hedged forecast cash flows affect profit or loss:									
Forecast payable cash flows	(5)	(6)	(11)	(16)	(22)	(139)	–	–	(199)

There were no transactions for which cash flow hedge accounting had to be ceased in 2011 or 2010 as a result of the highly probable cash flows no longer being expected to occur.

At 31 December 2011 £31,226 million of total recognised derivative assets of the Bank and £28,895 million of total recognised derivative liabilities of the Bank (2010: £17,047 million of assets and £8,123 million of liabilities) had a contractual residual maturity of greater than one year.

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group and Bank should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in note 55.

18 Loans and advances to banks

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Lending to banks	**1,810**	1,042	**164,374**	146,585
Money market placements with banks	**30,810**	29,250	**3,536**	6,031
Total loans and advances to banks before allowance for impairment losses	**32,620**	30,292	**167,910**	152,616
Allowance for impairment losses (note 23)	**(14)**	(20)	**(14)**	(20)
Total loans and advances to banks	**32,606**	30,272	**167,896**	152,596

At 31 December 2011 £4,128 million (2010: £2,449 million) of loans and advances to banks of the Group and £126,953 million (2010: £22,258 million) of the Bank had a contractual residual maturity of greater than one year.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £508 million (2010: £4,185 million) for the Group and £38,543 million (2010: £61,099 million) for the Bank. Collateral is held with a fair value of £511 million (2010: £3,909 million) for the Group and £38,860 million (2010: £61,926 million) for the Bank, all of which the Group and Bank are able to repledge.

Included in the amounts reported above in 2010 are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to Group £4 million and £nil for the Bank.

19 Loans and advances to customers

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Agriculture, forestry and fishing	**5,198**	5,558	**1,984**	2,513
Energy and water supply	**4,013**	3,576	**2,338**	2,418
Manufacturing	**10,061**	11,495	**6,188**	7,217
Construction	**9,722**	7,904	**4,203**	3,017
Transport, distribution and hotels	**32,882**	34,176	**12,473**	10,982
Postal and telecommunications	**1,896**	1,908	**1,537**	893
Property companies	**64,752**	78,263	**24,217**	22,987
Financial, business and other services	**64,046**	59,363	**27,045**	24,036
Personal:				
Mortgages	**348,210**	356,261	**94,024**	98,938
Other	**30,014**	36,967	**14,560**	16,304
Lease financing	**7,800**	8,291	**586**	457
Hire purchase	**5,776**	7,208	**464**	523
Due from fellow Group undertakings	**18,599**	18,492	**62,963**	64,039
Total loans and advances to customers before allowance for impairment losses	**602,969**	629,462	**252,582**	254,324
Allowance for impairment losses (note 23)	**(18,732)**	(18,373)	**(3,469)**	(3,151)
Total loans and advances to customers	**584,237**	611,089	**249,113**	251,173

At 31 December 2011 £469,454 million (2010: £511,650 million) of loans and advances to customers of the Group and £195,720 million (2010: £170,780 million) of the Bank had a contractual residual maturity of greater than one year.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £16,835 million (2010: £3,096 million) for the Group and £2,585 million (2010: £517 million) for the Bank. Collateral is held with a fair value of £16,936 million (2010: £2,987 million) for the Group and £2,682 million (2010: £510 million) for the Bank, all of which the Group and Bank are able to repledge.

Included in the amounts reported above are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £34 million (2010: £42 million) for the Group and £nil (2010: £nil) for the Bank.

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Gross investment in finance leases, receivable:				
Not later than 1 year	**1,168**	1,358	**44**	49
Later than 1 year and not later than 5 years	**2,754**	2,522	**253**	124
Later than 5 years	**6,355**	7,218	**593**	616
	10,277	11,098	**890**	789
Unearned future finance income on finance leases	**(2,391)**	(2,603)	**(304)**	(334)
Rentals received in advance	**(56)**	(183)	**–**	2
Commitments for expenditure in respect of equipment to be leased	**(30)**	(21)	**–**	–
Net investment in finance leases	**7,800**	8,291	**586**	457

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Not later than 1 year	**724**	986	**24**	24
Later than 1 year and not later than 5 years	**2,307**	1,965	**198**	60
Later than 5 years	**4,769**	5,340	**364**	373
Net investment in finance leases	**7,800**	8,291	**586**	457

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2011 and 2010 no contingent rentals in respect of finance leases were recognised in the income statement. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £92 million for the Group (2010: £287 million).

19 Loans and advances to customers (continued)

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Not later than 1 year	**56**	45	**5**	1
Later than 1 year and not later than 5 years	**137**	101	**1**	17
Later than 5 years	**20**	20	**–**	–
Total unguaranteed residual values	**213**	166	**6**	18

20 Securitisations and covered bonds

Securitisation programmes

Loans and advances to customers and debt securities classified as loans and receivables include loans securitised under the Group's securitisation programmes, the majority of which have been sold by Group companies to bankruptcy remote special purpose entities (SPEs). As the SPEs are funded by the issue of debt on terms whereby the majority of risks and rewards of the portfolio are retained by the Group company, the SPEs are consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue. In addition to the SPEs described below, the Group sponsors three conduit programmes, Argento, Cancara and Grampian (note 21).

Covered bond programmes

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of covered bonds by the Group. The Group retains all of the risks and rewards associated with these loans and the partnerships are consolidated fully with the loans retained on the Group's balance sheet, and the related covered bonds in issue included within debt securities in issue.

The Group's principal securitisation and covered bonds programmes, together with the balances of the loans subject to these arrangements and the carrying value of the notes in issue at 31 December, are listed below. The notes in issue are reported in note 36.

	2011		2010	
	Loans and advances securitised £m	**Notes in issue £m**	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes[1]				
UK residential mortgages	**129,764**	**94,080**	146,200	114,428
US residential mortgage-backed securities	**398**	**398**	–	–
Commercial loans	**13,313**	**11,342**	11,860	8,936
Irish residential mortgages	**5,497**	**5,661**	6,007	6,191
Credit card receivables	**6,763**	**4,810**	7,327	3,856
Dutch residential mortgages	**4,933**	**4,777**	4,526	4,316
Personal loans	**–**	**–**	3,012	2,011
PPP/PFI and project finance loans	**767**	**110**	776	110
Motor vehicle loans	**3,124**	**2,871**	926	975
	164,559	**124,049**	180,634	140,823
Less held by the Group		**(86,637)**		(100,081)
Total securitisation programmes (note 36)		**37,412**		40,742
Covered bond programmes				
Residential mortgage-backed	**91,023**	**67,456**	93,651	73,458
Social housing loan-backed	**3,363**	**2,605**	3,317	2,181
	94,386	**70,061**	96,968	75,639
Less held by the Group		**(31,865)**		(43,489)
Total covered bond programmes (note 36)		**38,196**		32,150
Total securitisation and covered bond programmes		**75,608**		72,892

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

Cash deposits of £20,435 million (2010: £36,579 million) held by the Group are restricted in use to repayment of the debt securities issued by the special purpose entities and other legal obligations.

21 Special purpose entities

In addition to the special purpose entities discussed in note 20, which are used for securitisation and covered bond programmes, the Group sponsors three asset-backed conduits, Argento, Cancara and Grampian, which invest in debt securities and client receivables. All of the external assets in these conduits are consolidated in the Group's financial statements. The total consolidated exposures in these conduits are set out in the table below:

	Argento £m	Cancara £m	Grampian £m	Total £m
At 31 December 2011				
Loans and advances	**130**	**3,962**	**73**	**4,165**
Debt securities:				
Classified as loans and receivables:				
Asset-backed securities	**1,022**	**–**	**2,004**	**3,026**
Corporate and other debt securities	**–**	**–**	**–**	**–**
	1,022	**–**	**2,004**	**3,026**
Classified as available-for-sale financial assets (note 24):				
Asset-backed securities	**733**	**21**	**796**	**1,550**
Corporate and other debt securities	**73**	**–**	**–**	**73**
	806	**21**	**796**	**1,623**
Total assets	**1,958**	**3,983**	**2,873**	**8,814**
At 31 December 2010				
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
	1,650	–	6,957	8,607
Classified as available-for-sale financial assets (note 24):				
Asset-backed securities	1,436	2,587	–	4,023
Corporate and other debt securities	463	–	–	463
	1,899	2,587	–	4,486
Total assets	3,549	6,544	6,957	17,050

Other special purpose entities

During 2009, the Group established Lloyds TSB Pension ABCS (No 1) LLP and Lloyds TSB Pension ABCS (No 2) LLP and transferred approximately £5 billion of assets, primarily comprising notes in certain of the Group's securitisation programmes, in aggregate to these entities. Further details are provided in note 42.

22 Debt securities classified as loans and receivables

Debt securities accounted for as loans and receivables comprise:

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Asset-backed securities:				
Mortgage-backed securities	**7,179**	11,650	**514**	653
Other asset-backed securities	**5,030**	12,827	**43**	99
Corporate and other debt securities	**537**	1,816	**192**	917
Total debt securities classified as loans and receivables before allowance for impairment losses	**12,746**	26,293	**749**	1,669
Allowance for impairment losses (see note 23)	**(276)**	(558)	**(116)**	(190)
Total debt securities classified as loans and receivables	**12,470**	25,735	**633**	1,479

For amounts included above which are subject to repurchase agreements see note 55.

23 Allowance for impairment losses on loans and receivables

The Group	**Loans and advances to customers £m**	**Loans and advances to banks £m**	**Debt securities £m**	**Total £m**
At 1 January 2010	4,813	149	245	5,207
Adjustment on transfer of HBOS	9,988	–	185	10,173
Exchange and other adjustments	118	(5)	(1)	112
Reclassifications	(120)	–	120	–
Advances written off	(6,966)	(111)	(48)	(7,125)
Recoveries of advances written off in previous years	216	–	–	216
Unwinding of discount	(403)	–	–	(403)
Charge (release) to the income statement	10,727	(13)	57	10,771
At 31 December 2010	18,373	20	558	18,951
Exchange and other adjustments	**(369)**	**–**	**2**	**(367)**
Advances written off	**(7,487)**	**(6)**	**(341)**	**(7,834)**
Recoveries of advances written off in previous years	**421**	**–**	**8**	**429**
Unwinding of discount	**(226)**	**–**	**–**	**(226)**
Charge to the income statement	**8,020**	**–**	**49**	**8,069**
At 31 December 2011	**18,732**	**14**	**276**	**19,022**

Of the Group's total allowance in respect of loans and advances to customers, £17,021 million (2010: £15,585 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the Group's total allowance in respect of loans and advances to customers, £3,832 million (2010: £6,076 million) was assessed on a collective basis.

The Bank	**Loans and advances to customers £m**	**Loans and advances to banks £m**	**Debt securities £m**	**Total £m**
At 1 January 2010	3,595	149	245	3,989
Exchange and other adjustments	15	(5)	(5)	5
Reclassifications	(120)	–	120	–
Advances written off	(2,772)	(111)	(187)	(3,070)
Recoveries of advances written off in previous years	159	–	–	159
Unwinding of discount	(93)	–	–	(93)
Charge (release) to the income statement	2,367	(13)	17	2,371
At 31 December 2010	3,151	20	190	3,361
Exchange and other adjustments	**–**	**–**	**4**	**4**
Advances written off	**(2,307)**	**(6)**	**(96)**	**(2,409)**
Recoveries of advances written off in previous years	**284**	**–**	**–**	**284**
Unwinding of discount	**(103)**	**–**	**–**	**(103)**
Charge to the income statement	**2,444**	**–**	**18**	**2,462**
At 31 December 2011	**3,469**	**14**	**116**	**3,599**

Of the Bank's total allowance in respect of loans and advances to customers, £2,952 million (2010: £2,755 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the Bank's total allowance in respect of loans and advances to customers, £1,272 million (2010: £1,450 million) was assessed on a collective basis.

24 Available-for-sale financial assets

The Group	2011 Conduits £m	2011 Other £m	2011 Total £m	2010 Conduits £m	2010 Other £m	2010 Total £m
Debt securities:						
Government securities	–	25,236	25,236	–	12,552	12,552
Other public sector securities	–	27	27	–	29	29
Bank and building society certificates of deposit	–	366	366	–	407	407
Asset-backed securities:						
Mortgage-backed securities	1,255	548	1,803	3,203	1,090	4,293
Other asset-backed securities	295	769	1,064	820	4,399	5,219
Corporate and other debt securities	73	5,718	5,791	463	11,669	12,132
	1,623	32,664	34,287	4,486	30,146	34,632
Equity shares	–	1,938	1,938	–	2,255	2,255
Treasury bills and similar securities	–	1,727	1,727	–	6,068	6,068
Total available-for-sale financial assets	1,623	36,329	37,952	4,486	38,469	42,955

The Bank	2011 £m	2010 £m
Debt securities:		
Government securities	25,067	12,405
Other public sector securities	27	29
Bank and building society certificates of deposit	329	272
Asset-backed securities:		
Mortgage-backed securities	497	971
Other asset-backed securities	305	1,254
Corporate and other debt securities	5,050	6,023
	31,275	20,954
Equity shares	47	73
Treasury bills and similar securities	29	3,924
Total available-for-sale financial assets	31,351	24,951

Details of the Group's asset-backed conduits shown in the table above are included in note 21.

Further information on asset-backed security exposures is provided in note 55.

At 31 December 2011 £42,702 million (2010: £38,967 million) of available-for-sale financial assets of the Group and £37,754 million (2010: £26,518 million) of the Bank had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase agreements see note 54.

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 2h(2). Included in available-for-sale financial assets at 31 December 2011 are debt securities individually determined to be impaired whose gross amount before impairment allowances was £2 million (2010: £2 million) and in respect of which no collateral was held.

At 31 December 2011, the Bank had sold £150 million (2010: £254 million) of debt securities to one of its subsidiary undertakings; however the related agreement is such that the Bank has retained substantially all of the risks and rewards of ownership and, as a consequence, the debt securities continue to be recognised on the Bank's balance sheet.

25 Held-to-maturity investments

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Debt securities: government securities	**8,098**	7,905	**8,098**	7,905

26 Investment properties of the Group

	2011 £m	2010 £m
At 1 January	**5,997**	2,340
Adjustment on transfer of HBOS (note 31)	**–**	2,417
Exchange and other adjustments	**(16)**	(6)
Additions:		
Acquisitions of new properties	**396**	398
Consolidation of new subsidiary undertakings	**922**	921
Additional expenditure on existing properties	**81**	52
Total additions	**1,399**	1,371
Disposals	**(1,151)**	(559)
Changes in fair value (note 7)	**(107)**	434
At 31 December	**6,122**	5,997

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

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

	2011 £m	2010 £m
Rental income	**388**	337
Direct operating expenses arising from investment properties that generate rental income	**50**	77

Capital expenditure in respect of investment properties:

	2011 £m	2010 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	**33**	86

27 Goodwill of the Group

	2011 £m	2010 £m
At 1 January and 31 December	**2,016**	2,016
Cost[1]	**2,362**	2,362
Accumulated impairment losses	**(346)**	(346)
At 31 December	**2,016**	2,016

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

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,016 million (31 December 2010: £2,016 million), £1,836 million (or 91 per cent of the total) has been allocated to Scottish Widows and £170 million (or 8 per cent of the total) to Asset Finance.

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

The recoverable amount of Asset Finance has also been based on a value in use calculation using pre-tax cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 17.75 per cent (gross of tax). The cash flows beyond the five-year period are extrapolated using a growth rate of 0.50 per cent which does not exceed the long-term average growth rates for the markets in which Asset Finance participates. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of Asset Finance to fall below its balance sheet carrying value.

28 Value of in-force business of the Group

The gross value of in-force business asset in the consolidated balance sheet is as follows:

	2011 £m	2010 £m
Acquired value of in-force non-participating investment contracts	1,391	1,469
Value of in-force insurance and participating investment contracts	5,247	5,898
Total value of in-force business	**6,638**	7,367

The movement in the acquired value of in-force non-particpating investment contracts over the year is as follows:

	2011 £m	2010 £m
At 1 January	1,469	–
Adjustment on transfer of HBOS (note 31)	–	1,545
Amortisation taken to income statement (note 11)	(78)	(76)
At 31 December	**1,391**	1,469

The acquired value of in-force non-particpating investment contracts includes £329 million (2010: £356 million) in relation to OEIC business.

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

	2011 £m	2010 £m
At 1 January	5,898	2,403
Adjustment on transfer of HBOS (note 31)	–	2,737
Exchange and other adjustments	(29)	(31)
Movements in the year:		
New business	552	497
Existing business:		
Expected return	(437)	(400)
Experience variances	117	85
Non-economic assumption changes	(576)	306
Economic variance	(278)	301
Movement in the value of in-force business taken to income statement (note 9)	(622)	789
At 31 December	**5,247**	5,898

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

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

Economic assumptions

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

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

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. The value of the in-force business asset for UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of corporate bond holdings. The illiquidity premium is estimated to be 119 basis points as at 31 December 2011 (31 December 2010: 75 basis points).

28 Value of in-force business of the Group (continued)

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

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

	2011 %	2010 %
Risk-free rate (value of in-force non-annuity business)	**2.48**	3.99
Risk-free rate (value of in-force annuity business)	**3.76**	4.66
Risk-free rate (financial options and guarantees)	**0.22 to 3.36**	0.63 to 4.50
Retail price inflation	**3.35**	3.56
Expense inflation	**4.01**	4.20

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

Non-economic assumptions
Future mortality, morbidity, expenses, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience.

Mortality and morbidity
The mortality and morbidity assumptions, including allowances for improvements in longevity, are set with regard to the Group's actual experience where this provides a reliable basis and relevant industry data otherwise. For German business, appropriate industry tables have been considered.

Lapse (persistency) and paid-up rates
Lapse and paid up rates assumptions are reviewed each year. The most recent experience is considered along with the results of previous analyses and management's views on future experience. In determining this best estimate view, a number of factors are considered, including the credibility of the results (which will be affected by the volume of data available), any exceptional events that have occurred during the period under consideration and any known or expected trends in underlying data.

Maintenance expenses
Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs. Explicit allowance is made for future expense inflation. For German business appropriate cost assumptions have been set in accordance with the rules of the local regulatory body.

These assumptions are intended to represent a best estimate of future experience, and further information about the effect of changes in key assumptions is given in note 38.

29 Other intangible assets

	The Group						The Bank
	Brands £m	Core deposit intangibles £m	Purchased credit card relation-ships £m	Customer related intangibles £m	Capitalised software enhance-ments £m	Total £m	Capitalised software enhance-ments £m
Cost:							
At 1 January 2010	–	–	–	63	311	374	190
Adjustment on transfer of HBOS (note 31)	596	2,770	300	814	175	4,655	–
Additions	–	–	–	–	154	154	42
Disposals	–	–	–	–	(30)	(30)	–
At 31 December 2010	596	2,770	300	877	610	5,153	232
Exchange and other adjustments	**–**	**–**	**–**	**–**	**5**	**5**	**1**
Additions	**–**	**–**	**–**	**4**	**369**	**373**	**259**
Disposals	**–**	**–**	**–**	**–**	**(25)**	**(25)**	**–**
At 31 December 2011	**596**	**2,770**	**300**	**881**	**959**	**5,506**	**492**
Accumulated amortisation:							
At 1 January 2010	–	–	–	18	151	169	79
Adjustment on transfer of HBOS (note 31)	21	393	58	219	84	775	–
Charge for the year	25	400	60	161	75	721	35
Disposals	–	–	–	–	(8)	(8)	–
At 31 December 2010	46	793	118	398	302	1,657	114
Exchange and other adjustments	**–**	**–**	**–**	**–**	**2**	**2**	**–**
Charge for the year	**19**	**399**	**60**	**88**	**97**	**663**	**49**
Disposals	**–**	**–**	**–**	**–**	**(12)**	**(12)**	**–**
At 31 December 2011	**65**	**1,192**	**178**	**486**	**389**	**2,310**	**163**
Balance sheet amount at 31 December 2011	**531**	**1,578**	**122**	**395**	**570**	**3,196**	**329**
Balance sheet amount at 31 December 2010	550	1,977	182	479	308	3,496	118

Included within brands above are assets of £380 million (31 December 2010: £380 million) that have been determined to have indefinite useful lives and are not amortised. These brands use the Bank of Scotland name which has been in existence for over 300 years. These brands are well established financial services brands and there are no indications that they should not continue indefinitely.

The customer-related intangibles include customer lists and the benefits of customer relationships that generate recurring income. The purchased credit card relationships represent the benefit of recurring income generated from the portfolio of credit cards purchased and the core deposit intangible is the benefit derived from a large stable deposit base that has low interest rates.

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

30 Tangible fixed assets

	The Group				The Bank		
	Premises £m	**Equipment £m**	**Operating lease assets £m**	**Total tangible fixed assets £m**	**Premises £m**	**Equipment £m**	**Total tangible fixed assets £m**
Cost:							
At 1 January 2010	1,544	4,227	2,084	7,855	1,184	2,983	4,167
Adjustment on transfer of HBOS (note 31)	917	1,108	4,299	6,324	–	–	–
Exchange and other adjustments	26	34	(76)	(16)	–	(5)	(5)
Additions	175	754	1,672	2,601	102	431	533
Disposals	(222)	(338)	(1,693)	(2,253)	(13)	(58)	(71)
Disposal of businesses	–	(1,005)	–	(1,005)	–	–	–
At 31 December 2010	2,440	4,780	6,286	13,506	1,273	3,351	4,624
Exchange and other adjustments	**(23)**	**(153)**	**(21)**	**(197)**	**–**	**–**	**–**
Additions	**173**	**767**	**1,436**	**2,376**	**102**	**486**	**588**
Disposals	**(122)**	**(395)**	**(1,851)**	**(2,368)**	**(32)**	**(126)**	**(158)**
Disposal of businesses	**(14)**	**(7)**	**(330)**	**(351)**	**–**	**–**	**–**
At 31 December 2011	**2,454**	**4,992**	**5,520**	**12,966**	**1,343**	**3,711**	**5,054**
Accumulated depreciation and impairment:							
At 1 January 2010	854	2,420	456	3,730	751	2,042	2,793
Adjustment on transfer of HBOS (note 31)	30	378	805	1,213	–	–	–
Exchange and other adjustments	2	(3)	30	29	(2)	(3)	(5)
Impairment charged to the income statement (note 11)	–	202	–	202	–	–	–
Depreciation charge for the year (note 11)	146	535	954	1,635	78	260	338
Disposals	(31)	(341)	(976)	(1,348)	(8)	(25)	(33)
Disposal of businesses	–	(145)	–	(145)	–	–	–
At 31 December 2010	1,001	3,046	1,269	5,316	819	2,274	3,093
Exchange and other adjustments	**(1)**	**15**	**20**	**34**	**1**	**1**	**2**
Impairment charged to the income statement (note 11)	**–**	**65**	**–**	**65**	**–**	**–**	**–**
Depreciation charge for the year (note 11)	**137**	**412**	**885**	**1,434**	**72**	**273**	**345**
Disposals	**(37)**	**(349)**	**(966)**	**(1,352)**	**(29)**	**(88)**	**(117)**
Disposal of businesses	**(3)**	**(6)**	**(195)**	**(204)**	**–**	**–**	**–**
At 31 December 2011	**1,097**	**3,183**	**1,013**	**5,293**	**863**	**2,460**	**3,323**
Balance sheet amount at 31 December 2011	**1,357**	**1,809**	**4,507**	**7,673**	**480**	**1,251**	**1,731**
Balance sheet amount at 31 December 2010	1,439	1,734	5,017	8,190	454	1,077	1,531

At 31 December the future minimum rentals receivable by the Group under non-cancellable operating leases were as follows:

	2011 £m	2010 £m
Receivable within 1 year	**987**	1,168
1 to 5 years	**1,389**	1,791
Over 5 years	**628**	638
Total future minimum rentals receivable	**3,004**	3,597

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2010 and 2011 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £40 million for the Group and £31 million for the Bank at 31 December 2011 (£55 million for the Group and £44 million for the Bank at 31 December 2010) is expected to be received under non-cancellable sub-leases of premises.

The impairment charge during 2010 of £202 million comprises £150 million relating to oil drilling rigs under construction acquired from a previous lending relationship in Wholesale (see note 14) and £52 million relating to integration activities.

31 Investment in subsidiary undertakings of the Bank

	2011 £m	2010 £m
At 1 January	**40,155**	15,960
Exchange and other adjustments	**(4)**	–
Transfer of HBOS (see below)	**–**	21,394
Additional capital injections and transfers	**159**	2,819
Disposals	**(4)**	(18)
Impairment	**(17)**	–
At 31 December	**40,289**	40,155

A reassessment of the carrying value of the Bank's investment in HBOS plc at 31 December 2011 concluded that the carrying value of the Bank's investment has not fallen below its recoverable amount.

Recoverable amount is based on the fair value less cost to sell and was determined by using a discounted cash flow valuation technique. This calculation uses projections of future cash flows based on management's plans covering a five year period. These cash flows are based on past experience and have been adjusted to take into account expected future market conditions. Cash flows beyond the five year period have been extrapolated using a steady 2.4 per cent rate of increase. The expected cash flows have been discounted at a rate of 17.75 per cent (pre-tax) which has been determined to be in line with available market information.

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

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Scotland plc	Scotland	100%	Banking and financial services
Scottish Widows plc	Scotland	100%[1]	Life assurance
HBOS plc	Scotland	100%	Holding company
Bank of Scotland plc	Scotland	100%[1]	Banking and financial services
HBOS Insurance & Investment Group Limited	England	100%[1]	Holding company
St. Andrew's Insurance plc	England	100%[1]	General insurance
Clerical Medical Investment Group Limited	England	100%[1]	Life assurance
Clerical Medical Managed Funds Limited	England	100%[1]	Life assurance

[1] Indirect interest.

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

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

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

Transfer of HBOS in 2010

On 1 January 2010, as part of a restructuring of the Lloyds Banking Group, Lloyds Banking Group plc's investment in 100 per cent of the ordinary share capital of HBOS plc was transferred to Lloyds TSB Bank plc for a consideration of £21,394 million. The consideration was satisfied by the issue of 21.4 million ordinary shares in Lloyds TSB Bank plc to Lloyds Banking Group plc.

In accordance with the accounting treatment available under IFRS 3 (Revised) for business combinations involving entities under common control, Lloyds TSB Bank plc was not required to fair value the acquired business at the date of transfer. Instead, the assets and liabilities were incorporated at the amounts at which they were recorded within Lloyds Banking Group at that date. The difference between the consolidated net asset value of HBOS plc at the date of transfer and the consideration paid, which was equal to Lloyds Banking Group plc's original cost of investment, has been credited to a merger reserve.

The post-transfer impact of HBOS plc on the Group's consolidated income statement for the year ended 31 December 2010 was as follows:

	£m
Net interest income	7,757
Other income	16,431
Total income	24,188
Insurance claims	(9,125)
Total income, net of insurance claims	15,063
Operating expenses	(6,260)
Trading surplus	8,803
Impairment	(8,108)
Share of results of joint ventures and associates	(94)
Profit before tax	601

31 Investment in subsidiary undertakings of the Bank (continued)

The consolidated balance sheet of HBOS plc at the date of transfer, with assets and liabilities incorporated at the amounts at which they were recorded within Lloyds Banking Group, was as follows:

		£m
Assets		
Cash and balances at central banks		2,905
Items in course of collection from banks		534
Trading and other financial assets at fair value through profit or loss		101,119
Derivative financial instruments		30,919
Loans and receivables:		
Loans and advances to banks	9,928	
Loans and advances to customers	395,931	
Debt securities	30,016	
		435,875
Available-for-sale financial assets		21,459
Investment properties		2,417
Investments in joint ventures and associates		423
Value of in-force business		4,282
Other intangible assets		3,880
Tangible fixed assets		5,111
Current tax recoverable		495
Deferred tax assets		2,811
Retirement benefit assets		67
Amounts due from fellow Lloyds Banking Group undertakings		92,679
Other assets		7,235
Total assets		712,211
Equity and liabilities		
Deposits from other banks		29,600
Customer deposits		232,091
Items in course of transmission to banks		495
Trading and other financial liabilities at fair value through profit or loss		21,909
Derivative financial instruments		25,801
Notes in circulation		981
Debt securities in issue		112,815
Liabilities arising from insurance contracts and participating investment contracts		39,231
Liabilities arising from non-participating investment contracts		30,614
Unallocated surplus within insurance businesses		772
Amounts due to fellow Lloyds Banking Group undertakings		156,098
Other liabilities		17,092
Retirement benefit obligations		373
Current tax liabilities		29
Deferred tax liabilities		208
Other provisions		436
Subordinated liabilities		14,653
Total liabilities		683,198
Equity		
Shareholders' equity		27,742
Non-controlling interests		1,271
Total equity		29,013
Total equity and liabilities		712,211

32 Other assets

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Assets arising from reinsurance contracts held (notes 37 and 39)	**2,534**	2,146	**–**	–
Deferred acquisition and origination costs (see below)	**693**	602	**–**	–
Settlement balances	**1,193**	985	**357**	236
Corporate pension asset	**3,873**	2,320	**–**	–
Other assets and prepayments	**6,185**	6,379	**900**	1,007
Total other assets	**14,478**	12,432	**1,257**	1,243

	2011 £m	2010 £m
Deferred acquisition and origination costs of the Group:		
At 1 January	**602**	188
Exchange and other adjustments	**(1)**	–
Adjustment on transfer of HBOS (note 31)	**–**	345
Acquisition and origination costs deferred, net of amounts amortised to the income statement	**92**	69
At 31 December	**693**	602

33 Deposits from banks

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Liabilities in respect of securities sold under repurchase agreements	**14,389**	24,017	**15,471**	19,064
Other deposits from banks	**25,421**	26,346	**139,121**	99,273
Total deposits from banks	**39,810**	50,363	**154,592**	118,337

At 31 December 2011 £12,387 million (2010: £11,453 million) of deposits from banks of the Group and £95,083 million (2010: £10,562 million) of the Bank had a contractual residual maturity of greater than one year.

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £13,933 million (2010: £22,420 million) for the Group and £22,660 million (2010: £36,886 million) for the Bank and a fair value of £14,258 million (2010: £25,626 million) for the Group and £23,302 million (2010: £25,626 million) for the Bank.

34 Customer deposits

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Non-interest bearing current accounts	**29,468**	22,897	**17,297**	16,438
Interest bearing current accounts	**72,562**	77,785	**40,214**	39,291
Savings and investment accounts	**238,132**	222,226	**79,681**	72,376
Liabilities in respect of securities sold under repurchase agreements	**7,996**	11,145	**4,117**	3,033
Other customer deposits	**76,219**	82,223	**86,244**	92,674
Total customer deposits	**424,377**	416,276	**227,553**	223,812

At 31 December 2011 £48,347 million (2010: £57,124 million) of customer deposits of the Group and £39,694 million (2010: £36,636 million) of the Bank had a contractual residual maturity of greater than one year.

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £7,987 million (2010: £11,112 million) for the Group and £5,552 million for the Bank (2010: £3,033 million) and a fair value of £8,088 million (2010: £11,278 million) for the Group and £5,713 million (2010: £3,023 million) for the Bank.

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £323 million (2010: £122 million) for the Group and £nil (2010: £nil) for the Bank.

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Liabilities held at fair value through profit or loss (debt securities)	**5,339**	6,665	**5,339**	6,665
Trading liabilities:				
Liabilites in respect of securities sold under repurchase agreements	**12,378**	14,612	**–**	–
Short positions in securities	**3,701**	1,755	**1,964**	894
Other	**3,537**	3,730	**3,602**	3,709
	19,616	20,097	**5,566**	4,603
Trading and other financial liabilities at fair value through profit or loss	**24,955**	26,762	**10,905**	11,268

At 31 December 2011, the Group had £9,433 million (2010: £8,627 million) and the Bank had £9,067 million (2010: £8,627 million) of trading and other liabilities at fair value through profit or loss with a contractual residual maturity of greater than one year.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2011 was £5,487 million (2010: £6,607 million), which was £148 million higher than the balance sheet carrying value (2010: £58 million lower). At 31 December 2011 there was a cumulative £183 million decrease (2010: £11 million increase) in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of the Bank. Of the cumulative amount, a decrease of £194 million arose in 2011 and none arose in 2010.

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

36 Debt securities in issue

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Medium-term notes issued	**62,811**	80,426	**50,824**	56,747
Covered bonds (note 20)	**38,196**	32,150	**11,545**	4,642
Certificates of deposit issued	**27,994**	42,276	**27,644**	39,246
Securitisation notes (note 20)	**37,412**	40,742	**8,235**	5,658
Commercial paper	**18,091**	32,723	**3,989**	8,829
Total debt securities in issue	**184,504**	228,317	**102,237**	115,122

At 31 December 2011 £101,726 million (2010: £118,296 million) of debt securities in issue of the Group and £43,031 million (2010: £48,781 million) of the Bank had a contractual residual maturity of greater than one year.

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

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

	2011			2010		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	62,409	(2,452)	59,957	61,891	(2,044)	59,847
Participating investment contracts	15,631	–	15,631	17,642	–	17,642
	78,040	(2,452)	75,588	79,533	(2,044)	77,489
Non-life insurance contracts (see (2) below):						
Unearned premiums	566	(23)	543	632	(22)	610
Claims outstanding	395	(2)	393	584	(15)	569
	961	(25)	936	1,216	(37)	1,179
Total	79,001	(2,477)	76,524	80,749	(2,081)	78,668

[1] Reinsurance balances are reported within other assets (note 32).

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

	Insurance contracts	Participating investment contracts	Gross £m	Reinsurance £m	Net £m
At 1 January 2010	24,077	12,273	36,350	(405)	35,945
Adjustment on transfer of HBOS (note 31)	32,735	5,815	38,550	(1,427)	37,123
New business	3,807	325	4,132	(48)	4,084
Changes in existing business	1,348	(858)	490	(208)	282
Change in liabilities charged to the income statement (note 10)	5,155	(533)	4,622	(256)	4,366
Exchange and other adjustments	(76)	87	11	44	55
At 31 December 2010	61,891	17,642	79,533	(2,044)	77,489
New business	4,340	86	4,426	(156)	4,270
Changes in existing business	(3,713)	(2,096)	(5,809)	(295)	(6,104)
Change in liabilities charged to the income statement (note 10)	627	(2,010)	(1,383)	(451)	(1,834)
Exchange and other adjustments	(109)	(1)	(110)	43	(67)
At 31 December 2011	62,409	15,631	78,040	(2,452)	75,588

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

	2011			2010		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	13,477	48,932	62,409	13,617	48,274	61,891
Participating investment contracts	9,488	6,143	15,631	10,648	6,994	17,642
Total	22,965	55,075	78,040	24,265	55,268	79,533

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

With-profit fund realistic liabilities
(i) Business description
The Group has with-profit funds within Scottish Widows plc and Clerical Medical Investment Group Limited containing both insurance contracts and participating investment contracts.

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

(ii) Method of calculation of liabilities
With-profit liabilities are stated at their realistic value, the main components of which are:

– With-profit benefit reserve, the total asset shares for with-profit policies;
– Cost of options and guarantees (including guaranteed annuity options);
– Deductions levied against asset shares;
– Planned enhancements to with-profits benefits reserve; and
– Impact of the smoothing policy.

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market-consistent basis. The calculation of realistic liabilities uses best estimate assumptions for mortality, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 28.

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

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

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

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

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

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

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

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

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

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

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

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

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

German insurance business is written through the Group's subsidiary Heidelberger Leben and comprises policies similar to the UK definitions above, except that there is participation by the policyholder in the investment, insurance and expense profits of Heidelberger Leben. A minimum level of policyholder participation is prescribed by German Law. The following types of life insurance contracts are written:

– Traditional or unit linked endowment or pensions business; and
– Life insurance business

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

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

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

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

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

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

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

Maintenance expenses
Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation. Explicit allowance is made for future expense inflation. For German business appropriate cost assumptions have been set in accordance with the rules of the local regulatory body.

Key changes in assumptions
A detailed review of the Group's assumptions in 2011 resulted in the following key impacts on profit before tax:

- Change in persistency assumptions (£5 million increase)
- Change in the assumption in respect of current and future mortality rates (£74 million decrease)
- Change in expense assumptions (£22 million increase)

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

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

	2011 £m	2010 £m
Credit protection	**206**	380
Home	**753**	833
Health	**2**	3
Total gross non-life insurance contract liabilities	**961**	1,216

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

The reserving methodology and associated assumptions are set out below:

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

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

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

	Gross £m	Reinsurance £m	Net £m
Provisions for unearned premiums			
At 1 January 2010	387	(11)	376
Adjustment on transfer of HBOS (note 31)	402	(20)	382
Increase in the year	1,230	(104)	1,126
Release in the year	(1,386)	113	(1,273)
Change in provision for unearned premiums charged to income statement (note 10)	(156)	9	(147)
Exchange and other adjustments	(1)	–	(1)
At 31 December 2010	632	(22)	610
Increase in the year	**1,082**	**(52)**	**1,030**
Release in the year	**(1,152)**	**52**	**(1,100)**
Change in provision for unearned premiums charged to income statement (note 10)	**(70)**	**–**	**(70)**
Exchange and other adjustments	**4**	**(1)**	**3**
At 31 December 2011	**566**	**(23)**	**543**

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

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

	Gross £m	Reinsurance £m	Net £m
Claims and loss adjustment expenses			
Notified claims	165	(3)	162
Incurred but not reported	58	–	58
At 1 January 2010	223	(3)	220
Adjustment on transfer of HBOS (note 31)	282	(9)	273
Cash paid for claims settled in the year	(467)	11	(456)
Increase (decrease) in liabilities:			
Arising from current year claims	581	(12)	569
Arising from prior year claims	(32)	(1)	(33)
Change in liabilities charged to income statement (note 10)	82	(2)	80
Exchange and other adjustments	(3)	(1)	(4)
At 31 December 2010	584	(15)	569
Cash paid for claims settled in the year	**(485)**	**–**	**(485)**
Increase (decrease) in liabilities:			
Arising from current year claims	**470**	**–**	**470**
Arising from prior year claims	**(171)**	**12**	**(159)**
Change in liabilities charged to income statement (note 10)	**(186)**	**12**	**(174)**
Exchange and other adjustments	**(3)**	**1**	**(2)**
At 31 December 2011	**395**	**(2)**	**393**
Notified claims	**313**	**(1)**	**312**
Incurred but not reported	**82**	**(1)**	**81**
At 31 December 2011	**395**	**(2)**	**393**
Notified claims	420	(4)	416
Incurred but not reported	164	(11)	153
At 31 December 2010	584	(15)	569

Non-life insurance claims development table

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

Non-life insurance all risks – gross

	Accident year							
	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	**2011 £m**	**Total £m**
Estimate of ultimate claims costs								
At end of accident year	211	208	317	205	262	609	**446**	**2,258**
One year later	207	206	311	199	237	517		
Two years later	204	204	299	195	216			
Three years later	202	204	292	187				
Four years later	201	205	285					
Five years later	201	203						
Six years later	201							
Current estimate in respect of above claims	201	203	285	187	216	517	**446**	**2,055**
Current estimate of claims relating to HBOS general insurance business transferred in 2010 (note 31)	273	316	388	256	278	–	**–**	**1,511**
Current estimate of cumulative claims	474	519	673	443	494	517	**446**	**3,566**
Cumulative payments to date	(470)	(514)	(668)	(432)	(463)	(443)	**(195)**	**(3,185)**
Liability recognised in the balance sheet	4	5	5	11	31	74	**251**	**381**
Liability in respect of earlier years[1]								**5**
Total liability included in the balance sheet								**386**

[1] This balance includes £nil million of claims outstanding relating to the HBOS general insurance business transferred in 2010 (note 31).

The liability of £386 million shown in the above table excludes £9 million of unallocated claims handling expenses.

38 Life insurance sensitivity analysis of the Group

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

31 December 2011	**Change in variable**	**Increase (reduction) in profit before tax £m**	**Increase (reduction) in equity £m**
Non-annuitant mortality[1]	**5% reduction**	**48**	**36**
Annuitant mortality[2]	**5% reduction**	**(154)**	**(115)**
Lapse rates[3]	**10% reduction**	**123**	**92**
Future maintenance and investment expenses[4]	**10% reduction**	**207**	**156**
Risk-free rate[5]	**0.25% reduction**	**55**	**41**
Guaranteed annuity option take-up[6]	**5% addition**	**(4)**	**(3)**
Equity investment volatility[7]	**1% addition**	**(9)**	**(7)**
Widening of credit default spreads on corporate bonds[8]	**0.25% addition**	**(164)**	**(123)**
Increase in illiquidity premia[9]	**0.10% addition**	**87**	**66**

31 December 2010	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
Non-annuitant mortality[1]	5% reduction	64	46
Annuitant mortality[2]	5% reduction	(131)	(96)
Lapse rates[3]	10% reduction	163	117
Future maintenance and investment expenses[4]	10% reduction	201	145
Risk-free rate[5]	0.25% reduction	61	44
Guaranteed annuity option take-up[6]	5% addition	(4)	(3)
Equity investment volatility[7]	1% addition	(8)	(6)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	(152)	(110)
Increase in illiquidity premia[9]	0.10% addition	78	56

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

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

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

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

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

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

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

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

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

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

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

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

	Gross £m	**Reinsurance[1] £m**	**Net £m**
At 1 January 2010	15,734	–	15,734
Adjustment on transfer of HBOS (note 31)	30,614	–	30,614
New business	3,953	(65)	3,888
Changes in existing business	1,070	–	1,070
Exchange and other adjustments	(8)	–	(8)
At 31 December 2010	51,363	(65)	51,298
New business	**4,194**	**(3)**	**4,191**
Changes in existing business	**(5,922)**	**11**	**(5,911)**
Exchange and other adjustments	**1**	**–**	**1**
At 31 December 2011	**49,636**	**(57)**	**49,579**

[1] Reinsurance balances are reported within other assets (note 32).

40 Unallocated surplus within insurance businesses for the Group

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

	2011 £m	2010 £m
At 1 January	**643**	310
Adjustment on transfer of HBOS (note 31)	**–**	772
Change in unallocated surplus recognised in the income statement (note 10)	**(340)**	(439)
Exchange and other adjustments	**(3)**	–
At 31 December	**300**	643

41 Other liabilities

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Settlement balances	**1,937**	1,269	**154**	6
Unitholders' interest in Open Ended Investment Companies	**18,249**	15,617	**–**	–
Other creditors and accruals	**12,339**	13,160	**4,210**	3,794
	32,525	30,046	**4,364**	3,800

42 Retirement benefit obligations

	2011 £m	2010 £m
Charge (credit) to the Group income statement:		
Defined benefit pension schemes[1]	**186**	(467)
Other post-retirement benefit schemes	**13**	12
Total defined benefit schemes	**199**	(455)
Defined contribution pension schemes	**202**	173
Total charge (credit) to the income statement	**401**	(282)

[1] In 2010, the amount is shown net of a credit of £910 million following the Group's decision to cap all future increases to pensionable salary in its principal UK defined benefit pension schemes, together with a change in commutation factors in certain schemes (see note 11).

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Amounts recognised in the balance sheet:				
Defined benefit pension schemes	**1,131**	479	**655**	356
Other post-retirement benefit schemes	**(174)**	(166)	**(118)**	(118)
Total amounts recognised in the balance sheet	**957**	313	**537**	238

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Amounts recognised in the balance sheet:				
Retirement benefit assets	**1,338**	736	**736**	530
Retirement benefit obligations	**(381)**	(423)	**(199)**	(292)
Total amounts recognised in the balance sheet	**957**	313	**537**	238

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

42 Retirement benefit obligations (continued)

Pension schemes

Defined benefit schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas, the three most significant being the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2 and the HBOS Final Salary Pension Scheme (HFSPS). These schemes provide retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2011 was generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The latest full valuations of the two main Lloyds TSB schemes were carried out as at 30 June 2008; the latest full valuation of the HFSPS was carried out as at 31 December 2008. The results have been updated to 31 December 2011 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2011 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The Group's and the Bank's obligations in respect of defined benefit schemes are funded. During 2009, the Group made one-off contributions to the Lloyds TSB Group Pension Scheme No 1 and the Lloyds TSB Group Pension Scheme No 2 of approximately £1 billion in aggregate. These contributions took the form of interests in limited liability partnerships for each of the two schemes which contained assets of approximately £5 billion in aggregate entitling the schemes to annual payments of approximately £215 million in aggregate until 31 December 2014. Thereafter, assuming that all distributions have been made, the value of the partnership interests will equate to a nominal amount. At 31 December 2011, the limited liability partnerships held assets of approximately £4.7 billion; cash payments of £215 million were made to the pension schemes during the year (2010: £215 million). The limited liability partnerships are fully consolidated in the Group's balance sheet (see note 21).

The Group currently expects to pay contributions of approximately £650 million to its defined benefit schemes in 2012.

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Amounts included in the balance sheet:				
Present value of funded obligations	**(28,236)**	(26,862)	**(14,635)**	(14,143)
Fair value of scheme assets	**28,828**	26,382	**14,549**	13,784
	592	(480)	**(86)**	(359)
Unrecognised actuarial losses	**539**	959	**741**	715
Net amount recognised in the balance sheet	**1,131**	479	**655**	356

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Movements in the defined benefit obligation:				
At 1 January	**(26,862)**	(18,796)	**(14,143)**	(14,363)
Adjustment on transfer of HBOS (note 31)	**–**	(8,277)	**–**	–
Current service cost	**(380)**	(384)	**(141)**	(144)
Employee contributions	**(1)**	(4)	**–**	–
Interest cost	**(1,423)**	(1,474)	**(704)**	(724)
Actuarial (losses) gains	**(514)**	140	**(132)**	256
Benefits paid	**912**	950	**475**	493
Past service cost	**(20)**	(46)	**(10)**	(40)
Curtailments	**25**	1,081	**24**	449
Settlements	**15**	6	**–**	–
Exchange and other adjustments	**12**	(58)	**(4)**	(70)
At 31 December	**(28,236)**	(26,862)	**(14,635)**	(14,143)

42 Retirement benefit obligations (continued)

Changes in the fair value of scheme assets:

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
At 1 January	**26,382**	16,075	**13,784**	12,507
Adjustment on transfer of HBOS (note 31)	**–**	7,443	**–**	–
Expected return	**1,627**	1,507	**791**	736
Employer contributions	**833**	648	**356**	182
Employee contributions	**1**	4	**–**	–
Actuarial gains	**926**	1,624	**96**	818
Benefits paid	**(912)**	(950)	**(475)**	(493)
Settlements	**(23)**	(9)	**–**	–
Exchange and other adjustments	**(6)**	40	**(3)**	34
At 31 December	**28,828**	26,382	**14,549**	13,784
Actual return on scheme assets	**2,553**	3,131	**887**	1,554

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

	2011 %	2010 %
Discount rate	**5.00**	5.50
Rate of inflation		
– Retail Prices Index	**3.00**	3.40
– Consumer Price Index	**2.00**	2.90
Rate of salary increases	**2.00**	2.00
Rate of increase for pensions in payment	**2.80**	3.20
	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.3**	27.2
Women	**28.4**	28.3
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.8**	28.2
Women	**30.0**	29.9

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2011 is assumed to live for, on average, 27.3 years for a male and 28.4 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

Sensitivity analysis
The effect of changes in key assumptions on the pension charge in the Group's income statement and on the Group's net defined benefit pension scheme asset or liability is set out below:

	Increase (decrease) in the income statement charge		**Increase (decrease) in the net defined benefit pension scheme asset**	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Inflation[1]:				
Increase of 0.2 per cent	**12**	14	**(798)**	(791)
Decrease of 0.2 per cent	**(6)**	(15)	**783**	754
Discount rate[2]:				
Increase of 0.2 per cent	**(10)**	(20)	**909**	930
Decrease of 0.2 per cent	**17**	15	**(957)**	(976)
Expected life expectancy of members:				
Increase of one year	**38**	40	**(655)**	(620)
Decrease of one year	**(40)**	(41)	**667**	632

[1] At 31 December 2011, the assumed rate of inflation is 3.00 per cent (31 December 2010: 3.40 per cent).
[2] At 31 December 2011, the assumed discount rate is 5.00 per cent (31 December 2010: 5.50 per cent).

42 Retirement benefit obligations (continued)

The expected return on scheme assets has been calculated using the following assumptions:

	2011 %	2010 %
Equities and alternative assets	**8.3**	8.3
Fixed interest gilts	**4.0**	4.5
Index linked gilts	**3.9**	4.1
Non-Government bonds	**4.9**	6.0
Property	**7.3**	7.5
Money market instruments and cash	**3.9**	4.3

The expected return on scheme assets in 2012 will be calculated using the following assumptions:

	2012 %
Equities and alternative assets	**7.3**
Fixed interest gilts	**3.0**
Index linked gilts	**2.8**
Non-Government bonds	**4.9**
Property	**6.6**
Money market instruments and cash	**2.6**

Composition of scheme assets:

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Equities	**10,728**	11,856	**5,455**	6,290
Fixed interest gilts	**995**	2,237	**368**	450
Index linked gilts	**6,211**	4,159	**3,895**	2,660
Non-Government bonds	**4,250**	2,922	**2,400**	1,916
Property	**1,708**	1,654	**1,109**	1,124
Money market instruments, cash and other assets and liabilities	**4,936**	3,554	**1,322**	1,344
At 31 December	**28,828**	26,382	**14,549**	13,784

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

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

Experience adjustments history:

The Group	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Present value of defined benefit obligation	**(28,236)**	(26,862)	(18,796)	(15,617)	(16,795)
Fair value of scheme assets	**28,828**	26,382	16,075	13,693	16,112
	592	(480)	(2,721)	(1,924)	(683)
Experience gains (losses) on scheme liabilities	**(277)**	496	(14)	(39)	(185)
Experience gains (losses) on scheme assets	**926**	1,624	542	(3,520)	139

The Bank	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Present value of defined benefit obligation	**(14,635)**	(14,143)	(14,363)	(12,015)	(12,899)
Fair value of scheme assets	**14,549**	13,784	12,507	10,488	12,410
	(86)	(359)	(1,856)	(1,527)	(489)
Experience gains (losses) on scheme liabilities	**(122)**	366	(4)	(23)	(150)
Experience gains (losses) on scheme assets	**122**	801	377	(2,750)	114

42 Retirement benefit obligations (continued)

The expense recognised in the consolidated income statement for the year ended 31 December comprises:

	2011 £m	2010 £m
Current service cost	**380**	384
Interest cost	**1,423**	1,474
Expected return on scheme assets	**(1,627)**	(1,507)
Net actuarial losses recognised in the year	**7**	43
Curtailments (see below)	**(25)**	(910)
Settlements	**8**	3
Past service cost	**20**	46
Total defined benefit pension expense	**186**	(467)

In 2010 the Group made changes to the terms of its principal UK defined benefit pension schemes, all future increases to pensionable salary will be capped each year at the lower of: Retail Prices Index inflation; each employee's actual percentage increase in pay; and 2 per cent of pensionable pay. In addition to this, during the second half of 2010 there was a change in the commutation factors in certain defined benefit schemes. The combined effect of these changes was a reduction in the Group's defined benefit obligation of £1,081 million and a reduction in the Group's unrecognised actuarial losses of £171 million, resulting in a net curtailment gain of £910 million recognised in the income statement in 2010 and an equivalent reduction in the balance sheet liability.

Defined contribution schemes

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

During the year ended 31 December 2011 the charge to the income statement in respect of defined contribution schemes was £202 million (2010: £173 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2008; this valuation has been updated to 31 December 2011 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.61 per cent (2010: 7.54 per cent).

Amount included in the balance sheet:

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Present value of unfunded obligations	**(188)**	(175)	**(121)**	(124)
Unrecognised actuarial losses	**14**	9	**3**	6
Retirement benefit obligation recognised in the balance sheet	**(174)**	(166)	**(118)**	(118)

Movements in the other post-retirement benefits obligation:

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
At 1 January	**(175)**	(120)	**(124)**	(120)
Adjustment on transfer of HBOS (note 31)	**–**	(50)	**–**	–
Exchange and other adjustments	**(5)**	2	**3**	1
Insurance premiums paid	**5**	5	**5**	5
Charge for the year	**(13)**	(12)	**(5)**	(10)
At 31 December	**(188)**	(175)	**(121)**	(124)

43 Deferred tax

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Asset at 1 January	**3,957**	2,438	**2,796**	2,672
Adjustment on transfer of HBOS (note 31)	**–**	2,603	**–**	–
Exchange and other adjustments	**4**	66	**3**	–
Disposals	**10**	–	**–**	–
Income statement (charge) credit (note 15):				
Due to change in corporation tax rate	**(411)**	(142)	**(267)**	(103)
Other	**1,527**	(716)	**1,196**	484
	1,116	(858)	**929**	381
Amount (charged) credited to equity:				
Available-for-sale financial assets (note 48)	**(574)**	(330)	**(602)**	(249)
Cash flow hedges (note 48)	**(262)**	38	**–**	(8)
	(836)	(292)	**(602)**	(257)
Asset at 31 December	**4,251**	3,957	**3,126**	2,796

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Statutory position				
Deferred tax assets	**4,565**	4,204	**3,127**	2,796
Deferred tax liabilities	**(314)**	(247)	**(1)**	–
Net deferred tax asset	**4,251**	3,957	**3,126**	2,796
Tax disclosure				
Deferred tax assets	**7,964**	8,438	**3,176**	2,821
Deferred tax liabilities	**(3,713)**	(4,481)	**(50)**	(25)
Net deferred tax asset	**4,251**	3,957	**3,126**	2,796

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

	2011 £m	2010 £m
Accelerated capital allowances	**319**	(470)
Pensions and other post-retirement benefits	**(160)**	(391)
Long-term assurance business	**595**	(110)
Trading losses	**(40)**	880
Tax on fair value of acquired assets	**(106)**	(715)
Other temporary differences	**508**	(52)
Deferred tax credit in the income statement	**1,116**	(858)

43 Deferred tax (continued)

Deferred tax assets and liabilities are comprised as follows:

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Deferred tax assets:				
Pensions and other post-retirement benefits	**–**	40	**–**	67
Allowances for impairment losses	**534**	577	**51**	68
Other provisions	**222**	241	**82**	68
Derivatives	**–**	178	**40**	55
Available-for-sale asset revaluation	**288**	519	**–**	–
Tax losses carried forward	**5,901**	6,596	**1,956**	2,365
Accelerated capital allowances	**–**	–	**234**	163
Other temporary differences	**1,019**	287	**813**	35
Total deferred tax assets	**7,964**	8,438	**3,176**	2,821
Deferred tax liabilities:				
Pensions and other post retirement benefits	**(120)**	–	**(20)**	–
Accelerated capital allowances	**(243)**	(562)	**–**	–
Long-term assurance business	**(979)**	(1,630)	**–**	–
Tax on fair value of acquired assets	**(1,890)**	(2,097)	**–**	–
Derivatives	**(173)**	–	**–**	–
Other temporary differences	**(308)**	(192)	**(30)**	(25)
Total deferred tax liabilities	**(3,713)**	(4,481)	**(50)**	(25)

On 23 March 2011, the Government announced that the corporation tax rate applicable from 1 April 2011 would be 26 per cent. This change passed into legislation on 29 March 2011. In addition, the Finance Act 2011, which passed into law on 19 July 2011, included legislation to reduce the main rate of corporation tax from 26 per cent to 25 per cent with effect from 1 April 2012. The change in the main rate of corporation tax from 27 per cent to 25 per cent has resulted in a reduction in the Group's net deferred tax asset at 31 December 2011 of £399 million, comprising the £411 million charge included in the income statement and an £12 million credit included in equity.

The proposed further reductions in the rate of corporation tax by 1 per cent per annum to 23 per cent by 1 April 2014 are expected to be enacted separately each year. The effect of these further changes upon the Group's deferred tax balances and leasing business cannot be reliably quantified at this stage.

Deferred tax assets
Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable. Group companies have recognised a deferred tax asset of £5,901 million and £1,956 million for the Bank (2010: £6,596 million for the Group and £2,365 million for the Bank) in relation to trading losses carried forward. After reviews of medium-term profit forecasts, the Group considers that there will be sufficient profits in the future against which these trading losses will be offset.

Deferred tax assets of £733 million for the Group (2010: £227 million) and nil for the Bank (2010: nil) have not been recognised in respect of trading losses carried forward, mainly in certain overseas companies and in respect of other temporary differences in the insurance business. Trading losses can be carried forward indefinitely, except losses in Spain which expire after 18 years.

Deferred tax assets of £384 million for the Group (2010: £396 million) and £38 million for the Bank (2010: £35 million) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of unrelieved foreign tax carried forward as at 31 December 2011 of £171 million for the Group (2010: £62 million) and £131 million (2010: £22 million) for the Bank, as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. These tax credits can be carried forward indefinitely.

Deferred tax liabilities
Scottish Widows plc has a taxable difference of £152 million (2010: 152 million) in respect of its holding of a life insurance subsidiary. No deferred tax liability is required to be recognised in respect of this taxable temporary difference under IAS 12 as Scottish Widows plc does not intend to dispose of this subsidiary company.

44 Other provisions

The Group	Provisions for commitments £m	Customer remediation provisions £m	Customer goodwill payments £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2011	154	344	500	146	388	1,532
Exchange and other adjustments	(14)	51	–	(21)	79	95
Provisions applied	(4)	(1,280)	(497)	–	(56)	(1,837)
Charge (release) for the year	(55)	3,381	–	15	35	3,376
At 31 December 2011	81	2,496	3	140	446	3,166

The Bank	Provisions for commitments £m	Customer remediation provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2011	123	149	52	245	569
Exchange and other adjustments	1	17	1	21	40
Provisions applied	–	(796)	–	(36)	(832)
Charge (release) for the year	(62)	1,868	19	22	1,847
At 31 December 2011	62	1,238	72	252	1,624

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

Customer remediation provisions
Payment protection insurance
There has been extensive scrutiny of the Payment Protection Insurance (PPI) market in recent years.

In October 2010, the UK Competition Commission confirmed its decision to prohibit the active sale of PPI by a distributor to a customer within seven days of a sale of credit. This followed the completion of its formal investigation into the supply of PPI services (other than store card PPI) to non-business customers in the UK in January 2009 and a referral of the proposed prohibition to the Competition Appeal Tribunal. The Competition Commission consulted on the wording of a draft Order to implement its findings from October 2010, and published the final Order on 24 March 2011 which became effective on 6 April 2011. Following an earlier decision to stop selling single premium PPI products, the Group ceased to offer PPI products to its customers in July 2010.

On 29 September 2009 the FSA announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. Lloyds Banking Group agreed in principle that it would undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. That review will now form part of the ongoing PPI work referred to below.

On 1 July 2008, the Financial Ombudsman Service (FOS) referred concerns regarding the handling of PPI complaints to the Financial Services Authority (FSA) as an issue of wider implication. On 29 September 2009 and 9 March 2010, the FSA issued consultation papers on PPI complaints handling. The FSA published its Policy Statement on 10 August 2010, setting out evidential provisions and guidance on the fair assessment of a complaint and the calculation of redress, as well as a requirement for firms to reassess historically rejected complaints which had to be implemented by 1 December 2010.

On 8 October 2010, the British Bankers' Association (BBA), the principal trade association for the UK banking and financial services sector, filed an application for permission to seek judicial review against the FSA and the FOS. The BBA sought an order quashing the FSA Policy Statement and an order quashing the decision of the FOS to determine PPI sales in accordance with the guidance published on its website in November 2008.

The Judicial Review hearing was held in late January 2011 and on 20 April 2011 judgment was handed down by the High Court dismissing the BBA's application. On 9 May 2011, the BBA confirmed that the banks and the BBA did not intend to appeal the judgment.

After publication of the judgment, the Group entered into discussions with the FSA with a view to seeking clarity around the detailed implementation of the Policy Statement. As a result, and given the initial analysis that the Group has conducted of compliance with applicable sales standards, which is continuing, the Group has concluded that there are certain circumstances where customer contact and/or redress will be appropriate. Accordingly the Group has made a provision in its income statement for the year ended 31 December 2011 of £3,200 million in respect of the anticipated costs of such contact and/or redress, including administration expenses. During 2011, the Group made redress payments of £1,045 million to customers. The Group anticipates that all claims will be settled by 2015. However, there are still a number of uncertainties as to the eventual costs from any such contact and/or redress given the inherent difficulties of assessing the impact of the detailed implementation of the Policy Statement for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs.

Litigation in relation to insurance branch business in Germany
During the year ended 31 December 2011 the Group has recognised a provision of £175 million in respect of litigation involving Clerical Medical Investment Group Limited in Germany. Further details are provided in note 53.

44 Other provisions (continued)

Other
The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2011 management has again reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made. At 31 December 2011 the remaining such provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks.

Customer goodwill payments
Following discussions with the FSA regarding the application of an interest rate variation clause in certain Bank of Scotland plc variable rate mortgage contracts Bank of Scotland plc applied for a Voluntary Variation of Permission (VVOP) in February 2011 and agreed to initiate a customer review and contact programme and to make goodwill payments to affected customers. The Group made a provision of £500 million within its 2010 accounts in respect of this matter. Since that time further information has become available which has resulted in Bank of Scotland plc applying for, and being granted, an amended VVOP by the FSA in November 2011. No additional charge is required at this time.

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

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

Other provisions include those arising out of the insolvency of a third party insurer, which remains exposed to asbestos and pollution claims in the US. The ultimate costs and timing of payments are uncertain. The provision held of £38 million at 31 December 2011 represents management's current best estimate of the cost after having regard to actuarial estimates of future losses.

45 Subordinated liabilities

The movement in subordinated liabilities during the year was as follows:

	The Group £m	The Bank £m
At 1 January 2010	15,999	15,456
Adjustment on transfer of HBOS (note 31)	14,653	–
Issued during the year	3,237	3,237
Repurchases and redemptions during the year	(684)	(353)
Foreign exchange and other movements	(3,596)	(2,766)
At 31 December 2010	29,609	15,574
Issued during the year	**10,922**	**10,389**
Repurchases and redemptions during the year	**(4,121)**	**(1,424)**
Foreign exchange and other movements	**920**	**506**
At 31 December 2011	**37,330**	**25,045**

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Preferred securities	**7,479**	6,932	**5,162**	5,006
Undated subordinated liabilities	**3,601**	3,056	**1,572**	1,520
Dated subordinated liabilities	**26,250**	19,621	**18,311**	9,048
Total subordinated liabilities	**37,330**	29,609	**25,045**	15,574

These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of the depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of the specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preference shares and preferred securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of the holders of the dated subordinated liabilities. Neither the Group nor the Bank has had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year (2010: none). No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the Financial Services Authority.

The Group	Note	**2011 £m**	2010 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)	e	**247**	249
Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a	**601**	584
Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a,d	**646**	628
6% Non-cumulative Redeemable Preference Shares	b	**–**	–
7.375% Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)		**16**	16
7.875% Non-cumulative Preference Shares callable 2013 (€500 million)	d	**239**	203
7.875% Non-cumulative Preference Shares callable 2013 (US$1,250 million)	d	**470**	353
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)		**239**	241
7.834% Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	d	**5**	4
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	d	**718**	711
13% Step-up Perpetual Capital Securities callable 2019 (£785 million)	d	**12**	10
13% Euro Step-up Perpetual Capital Securities callable 2019 (€532 million)	d	**47**	56
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		**1,301**	1,288
13% Step-up Perpetual Capital Securities callable 2029 (£700 million)	d	**612**	662
6.071% Non-cumulative Perpetual Preferred Securities (US$750 million)		**389**	336
6.85% Non-cumulative Perpetual Preferred Securities (US$1,000 million)	e	**316**	107
6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities (£600 million)		**444**	421
8.117% Non-cumulative Perpetual Preferred Securities (Class A) (£250 million)	e,f	**260**	253
7.754% Non-cumulative Perpetual Preferred Securities (Class B) (£150 million)		**104**	98
7.881% Guaranteed Non-voting Non-cumulative Preferred Securities (£245 million)		**228**	173
7.627% Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities (€415 million)	e,i	**340**	308
4.939% Non-voting Non-cumulative Perpetual Preferred Securities (€750 million)	d	**20**	17
7.286% Perpetual Regulatory Tier One Securities (Series A) (£150 million)		**112**	119
7.281% Perpetual Regulatory Tier One Securities (Series B) (£150 million)		**113**	95
		7,479	6,932

45 Subordinated liabilities (continued)

	Note	**2011 £m**	2010 £m
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:			
Series 1 (US$750 million)	d,e,g	**175**	173
Series 2 (US$500 million)	d,e,g	**183**	181
Series 3 (US$600 million)	d,e,g	**235**	232
11.75% Perpetual Subordinated Bonds (£100 million)		**102**	102
6.625% Undated Subordinated Step-up Notes (£410 million)	d,e,h	**173**	174
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million) (Scottish Widows plc)		**554**	550
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)		**208**	194
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	d	**160**	142
6.5% Undated Subordinated Step-up Notes callable 2019 (£270 million)	d	**104**	97
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	d	**–**	–
6.5% Undated Subordinated Step-up Notes callable 2029 (£450 million)	d	**118**	111
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	b	**114**	114
5.625% Cumulative Callable Fixed to Floating Rate Undated Subordinated Notes callable 2019 (£500 million)	d	**4**	3
4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)	d	**75**	65
Floating Rate Undated Subordinated Notes (€500 million)	d	**45**	42
5.375% Undated Fixed to Floating Rate Subordinated Notes (US$1,000 million)	d	**12**	12
5.125% Undated Subordinated Fixed to Floating Rate Notes (€750 million)	d	**52**	47
5.75% Undated Subordinated Step-up Notes (£600 million)		**3**	3
6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	e,j,k	**4**	57
7.5% Undated Subordinated Step-up Notes (£300 million)		**5**	3
8.625% Perpetual Subordinated Notes (£200 million)	d	**24**	21
7.375% Undated Subordinated Guaranteed Bonds (£200 million) (Clerical Medical Finance plc)		**36**	35
Floating Rate Undated Subordinated Step-up Notes (€300 million)	e,k	**10**	63
Floating Rate Primary Capital Notes (US$250 million)	d,e,g	**118**	118
10.25% Subordinated Undated Instruments (£100 million)	d	**1**	1
12% Perpetual Subordinated Bonds (£100 million)	d	**30**	21
8.75% Perpetual Subordinated Bonds (£100 million)	d	**4**	4
13.625% Perpetual Subordinated Bonds (£75 million)	d	**16**	20
9.375% Perpetual Subordinated Bonds (£50 million)	d	**17**	16
5.75% Undated Subordinated Step-up Notes (£500 million)		**3**	3
4.25% Perpetual Fixed to Floating Rate Reset Subordinated Guaranteed Notes (€750 million) (Clerical Medical Finance plc)		**231**	215
7.375% Subordinated Undated Instruments (£150 million)	d	**78**	76
4.25% Subordinated Undated Instruments (¥17,000 million)		**174**	161
Floating Rate Undated Subordinated Notes (£524 million) (Scottish Widows Group Limited)		**533**	–
		3,601	3,056

45 Subordinated liabilities (continued)

	Note	**2011 £m**	2010 £m
Dated subordinated liabilities			
12% Guaranteed Subordinated Bonds 2011 (£100 million)	c	**–**	109
4.75% Subordinated Notes 2011 (€850 million)		**–**	764
Subordinated Floating Rate Notes 2011 (£150 million)		**–**	150
Subordinated Floating Rate Notes 2011 (£100 million)		**–**	100
Subordinated Floating Rate Notes 2012 (£200 million)		**200**	200
Subordinated Floating Rate Notes 2013 (£150 million)		**150**	150
Subordinated Floating Rate Notes 2014 (£464 million)		**465**	465
5.875% Subordinated Notes 2014 (£150 million)		**154**	149
6.625% Subordinated Notes 2015 (£350 million)		**357**	343
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	k,l	**184**	296
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	k,l	**179**	432
5.625% Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		**902**	946
6.9625% Callable Subordinated Fixed to Floating Rate Notes 2020 callable 2015 (£750 million)		**725**	715
Subordinated Floating Rate Notes 2020 (€100 million)		**87**	86
5.75% Subordinated Fixed to Floating Rate Notes 2025 callable 2020 (£350 million)		**367**	324
9.625% Subordinated Bonds 2023 (£300 million)		**319**	332
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		**150**	150
6.50% Notes 2011 (US$150 million)		**–**	99
5.50% Subordinated Fixed Rate Notes 2012 (€750 million)		**640**	657
6.25% Instruments 2012 (€12.8 million)		**8**	10
6.125% Notes 2013 (€325 million)		**283**	289
4.25% Subordinated Guaranteed Notes 2013 (US$1,000 million)		**636**	619
11% Subordinated Bonds 2014 (£250 million)		**290**	297
4.875% Subordinated Notes 2015 (€1,000 million)		**854**	838
Callable Floating Rate Subordinated Notes 2016 callable 2011 (€500 million)	k,l	**88**	401
Callable Floating Rate Subordinated Notes 2016 callable 2011 (€500 million)	k,l	**124**	417
Subordinated Callable Notes 2016 callable 2011 (US$750 million)	k,l	**191**	440
Subordinated Callable Notes 2017 callable 2012 (€1,000 million)	k	**219**	758
Subordinated Callable Notes 2017 callable 2012 (US$1,000 million)	k	**192**	548
Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)	k	**38**	255
6.75% Subordinated Callable Fixed to Floating Rate Instruments 2017 (Aus$200 million)	k	**5**	127
5.109% Callable Fixed to Floating Rate Notes 2017 callable 2012 (Can$500 million)	k	**8**	305
6.305% Subordinated Callable Fixed to Floating Rate Notes 2017 callable 2012 (£500 million)	k	**22**	486
10.5% Subordinated Bonds 2018 (£150 million)		**177**	171
6.75% Subordinated Fixed Rate Notes 2018 (US$2,000 million)		**1,205**	1,176
6.375% Subordinated Instruments 2019 (£250 million)		**274**	236
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)		**621**	600
6.5% Dated Subordinated Notes 2020 (€1,500 million)		**1,407**	1,353
7.375% Dated Subordinated Notes 2020		**3**	4
6.5% Subordinated Fixed Rate Notes 2020 (US$2,000 million)		**1,360**	1,202
9.375% Subordinated Bonds 2021 (£500 million)		**709**	647
5.374% Subordinated Fixed Rate Notes 2021 (€160 million)		**150**	139
6.45% Fixed to Floating Subordinated Guaranteed Bonds 2023 (€400 million) (Clerical Medical Finance plc)		**176**	173
7.07% Subordinated Fixed Rate Notes 2023 (€175 million)		**174**	162
7.625% Dated Subordinated Notes 2025 (£750 million)		**876**	763
4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)		**463**	463
6% Subordinated Notes 2033 (US$750 million)		**432**	275
11.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (€1,147 million)	m	**977**	–
10.75% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (£466 million)	m	**467**	–
9.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (US$568 million)	m	**368**	–
10.125% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (Can$387 million)	m	**246**	–
13% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (Aus$417 million)	m	**276**	–
11.77% Subordinated Notes 2020		**97**	–
11.81% Subordinated Notes 2020		**65**	–

45 Subordinated liabilities (continued)

	2011 £m	2010 £m
Dated subordinated liabilities (continued)		
10.23% Subordinated Notes 2019 (£1,005 million)	**1,009**	–
10.17% Subordinated Notes 2020 (US$361 million)	**234**	–
11.84% Subordinated Notes 2020 (€496 million)	**416**	–
11.84% Subordinated Notes 2020 (€532 million)	**447**	–
10.21% Subordinated Notes 2020 (US$1,095 million)	**711**	–
11.88% Subordinated Notes 2020 (€176 million)	**148**	–
10.24% Subordinated Notes 2020 (US$854 million)	**554**	–
10.61% Subordinated Notes 2020 (£773 million)	**776**	–
10.33% Subordinated Notes 2021 (US$243 million)	**158**	–
10.67% Subordinated Notes 2020 (£614 million)	**616**	–
10.69% Subordinated Notes 2020 (£517 million)	**519**	–
10.75% Subordinated Notes 2022 (£101 million)	**101**	–
10.85% Subordinated Notes 2019 (£91 million)	**92**	–
10.86% Subordinated Notes 2019 (£292 million)	**293**	–
10.89% Subordinated Notes 2020 (£207 million)	**208**	–
10.88% Subordinated Notes 2019 (£4 million)	**3**	–
10.90% Subordinated Notes 2020 (£65 million)	**66**	–
10.90% Subordinated Notes 2019 (£126 million)	**126**	–
10.91% Subordinated Notes 2023 (£100 million)	**101**	–
11.02% Subordinated Notes 2024 (£83 million)	**84**	–
10.94% Subordinated Notes 2020 (£139 million)	**139**	–
10.95% Subordinated Notes 2024 (£39 million)	**39**	–
10.97% Subordinated Notes 2020 (£39 million)	**40**	–
10.92% Subordinated Notes 2024 (£83 million)	**83**	–
11.07% Subordinated Notes 2029 (£92 million)	**93**	–
11.18% Subordinated Notes 2023 (£57 million)	**58**	–
11.21% Subordinated Notes 2023 (£67 million)	**67**	–
11.46% Subordinated Notes 2029 (£92 million)	**92**	–
11.52% Subordinated Notes 2032 (£84 million)	**85**	–
11.35% Subordinated Notes 2019 (€603 million)	**507**	–
11.42% Subordinated Notes 2020 (€30 million)	**25**	–
	26,250	19,621
Total subordinated liabilities	**37,330**	29,609

At 31 December 2011 £36,482 million (2010: £28,486 million) of subordinated liabilities had a contractual residual maturity of greater than one year.

45 Subordinated liabilities (continued)

The Bank	Note	2011 £m	2010 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)		**247**	249
Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a	**601**	584
Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a,d	**646**	628
6% Non-cumulative Redeemable Preference Shares	b	**–**	–
7.375% Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	d	**17**	17
7.875% Non-cumulative Preference shares callable 2013 (€500 million)	d	**239**	203
7.875% Non-cumulative Preference shares callable 2013 (US$1,250 million)	d	**470**	353
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	e	**239**	241
7.834% Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	d	**5**	4
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	d	**718**	711
13% Step-up Perpetual Capital Securities callable 2019 (£785 million)	d	**12**	10
13% Step-up Perpetual Capital Securities callable 2019 (€532 million)	d	**47**	56
13% Step-up Perpetual Capital Securities callable 2029 (£700 million)	d	**620**	662
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		**1,301**	1,288
		5,162	5,006
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:			
Series 1 (US$750 million)	d,e,g	**175**	173
Series 2 (US$500 million)	d,e,g	**183**	181
Series 3 (US$600 million)	d,e,g	**235**	232
11.75% Perpetual Subordinated Bonds (£100 million)		**102**	102
6.625% Undated Subordinated Step-up Notes (£410 million)	d,e,h	**173**	174
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)		**208**	194
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	d	**160**	142
6.5% Undated Subordinated Step-up Notes callable 2019 (£270 million)	d	**104**	97
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	d	**–**	–
6.5% Undated Subordinated Step-up Notes callable 2029 (£450 million)	d	**118**	111
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	d	**114**	114
		1,572	1,520
Dated subordinated liabilities			
12% Guaranteed Subordinated Bonds 2011 (£100 million)	c	**–**	112
4.75% Subordinated Notes 2011 (€850 million)		**–**	764
Subordinated Floating Rate Notes 2011 (£150 million)		**–**	150
Subordinated Floating Rate Notes 2011 (£100 million)		**–**	100
Subordinated Floating Rate Notes 2012 (£200 million)		**200**	200
Subordinated Floating Rate Notes 2013 (£150 million)		**150**	150
Subordinated Floating Rate Notes 2014 (£464 million)		**465**	465
5.875% Subordinated Notes 2014 (£150 million)		**154**	149
6.625% Subordinated Notes 2015 (£350 million)		**357**	343
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	k,l	**184**	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	k,l	**179**	432
5.625% Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		**902**	946
6.9625% Callable Subordinated Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)		**744**	723
Subordinated Floating Rate Notes 2020 (€100 million)		**87**	86
5.75% Subordinated Fixed to Floating Rate Notes 2025 callable 2020 (£350 million)		**373**	324
9.625% Subordinated Bonds 2023 (£300 million)		**319**	332
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		**150**	150
6.5% Dated Subordinated Notes 2020 (€1,500 million)		**1,409**	1,353
7.375% Dated Subordinated Notes 2020		**4**	4
6.5% Subordinated Fixed Rate Notes 2020 (US$2,000 million)		**1,360**	1,202
7.625% Dated Subordinatd Notes 2025 (£750 million)		**888**	763
11.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (€1,147 million)	m	**977**	–
10.75% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (£466 million)	m	**467**	–
9.875% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (US$568 million)	m	**368**	–
10.125% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (Can$387 million)	m	**246**	–
13% Subordinated Fixed to Fixed Rate Notes 2021 callable 2016 (Aus$417 million)	m	**276**	–
11.77% Subordinated Notes 2020 (€115 million)		**97**	–
11.81% Subordinated Notes 2020 (€78 million)		**65**	–

45 Subordinated liabilities (continued)

The Bank (continued)	**2011 £m**	2010 £m
Dated subordinated liabilities (continued)		
10.55% Subordinated Notes 2019 (£1,005 million)	**1,009**	–
10.17% Subordinated Notes 2020 (US$361 million)	**234**	–
11.84% Subordinated Notes 2020 (€496 million)	**416**	–
11.84% Subordinated Notes 2020 (€532 million)	**447**	–
10.21% Subordinated Notes 2020 (US$1,095 million)	**711**	–
11.88% Subordinated Notes 2020 (€176 million)	**148**	–
10.24% Subordinated Notes 2020 (US$854 million)	**554**	–
10.61% Subordinated Notes 2020 (£773 million)	**776**	–
10.33% Subordinated Notes 2021 (US$243 million)	**158**	–
10.67% Subordinated Notes 2020 (£614 million)	**616**	–
10.69% Subordinated Notes 2020 (£517 million)	**519**	–
10.75% Subordinated Notes 2022 (£101 million)	**101**	–
10.85% Subordinated Notes 2019 (£91 million)	**92**	–
10.86% Subordinated Notes 2019 (£292 million)	**293**	–
10.89% Subordinated Notes 2020 (£207 million)	**208**	–
10.88% Subordinated Notes 2019 (£4 million)	**3**	–
10.90% Subordinated Notes 2020 (£65 million)	**66**	–
10.90% Subordinated Notes 2019 (£126 million)	**126**	–
10.91% Subordinated Notes 2023 (£100 million)	**101**	–
11.02% Subordinated Notes 2024 (£83 million)	**84**	–
10.94% Subordinated Notes 2020 (£139 million)	**139**	–
10.95% Subordinated Notes 2024 (£39 million)	**39**	–
10.97% Subordinated Notes 2020 (£39 million)	**40**	–
10.92% Subordinated Notes 2024 (£83 million)	**83**	–
11.07% Subordinated Notes 2029 (£92 million)	**93**	–
11.18% Subordinated Notes 2023 (£57 million)	**58**	–
11.21% Subordinated Notes 2023 (£67 million)	**67**	–
11.46% Subordinated Notes 2029 (£92 million)	**92**	–
11.52% Subordinated Notes 2032 (£84 million)	**85**	–
11.35% Subordinated Notes 2019 (€603 million)	**507**	–
11.42% Subordinated Notes 2020 (€30 million)	**25**	–
	18,311	9,048
Total subordinated liabilities	**25,045**	15,574

At 31 December 2011 £24,845 million (2010: £14,448 million) of subordinated liabilities had a contractual residual maturity of greater than one year.

45 Subordinated liabilities (continued)

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

b) Since 2004, the Bank has had in issue 400 6 per cent non-cumulative redeemable preference shares of 25p each. The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Bank. The holder of the 400 25p 6 per cent preference shares has waived its rights to payment for the period from 1st March 2010 to 1st March 2012.

c) Guaranteed by Lloyds Banking Group plc on a subordinated basis.

d) In November 2009, as part of the state aid restructuring plan, the Group agreed to suspend the payment of coupons on these instruments for the two year period from 31 January 2010 to 31 January 2012.

e) These securities are callable at specific dates as per the terms of the securities at the option of the issuer and with approval from the FSA. In November 2009, as part of the state aid restructuring plan, the Group agreed not to exercise any call options on these instruments for the two year period from 31 January 2010 to 31 January 2012.

f) The fixed rate on this security was reset from 8.117 per cent to 6.059 per cent with effect from 31 May 2010.

g) Following an exchange offer, on 28 May and 4 June 2010, certain holders elected to exchange some or all of the notes they held for equity issued by Lloyds Banking Group plc.

h) The fixed rate payable on this security was reset from 6.625 per cent to 4.64821 per cent with effect from 15 July 2010.

i) The fixed rate on this security was reset from 7.627 per cent to 3 months Euribor plus 2.875 per cent with effect from 9 December 2011.

j) The fixed rate on this security was reset from 6.05 per cent to 3 month Euribor plus 2.25 per cent with effect from 23 November 2011.

k) Following an exchange, on 1 December 2011, certain holders elected to exchange some or all of the notes they held for new dated subordinated liabilities issued by Lloyds TSB Bank plc.

l) These securities are callable at specific dates as per the terms of the securities at the option of the issuer and with approval of the FSA. In November 2009, as part of the state aid restructuring plan, the Group agreed not to exercise any call options on these instruments for the two year period from 31 January 2010 to 31 January 2012. The interest rate payable on these securities reset during 2011.

m) These securities were issued in December 2011 as a result of an exchange offer.

46 Share capital

(1) Authorised share capital

	Group and Bank	
	2011 £m	2010 £m
Sterling		
1,650 million ordinary shares of £1 each	**1,650**	1,650
1 cumulative floating rate Preference share of £1	**–**	–
100 6 per cent Non-Cumulative Redeemable Preference shares of £1 each	**–**	–
175 million Preference shares of 25p each	**44**	44
	1,694	1,694
US dollars	**US$m**	US$m
160 million Preference shares of 25 cents each	**40**	40
Euro	**€m**	€m
160 million Preference shares of 25 cents each	**40**	40
Japanese yen	**¥m**	¥m
50 million Preference shares of ¥25 each	**1,250**	1,250

(2) Issued and fully paid ordinary shares

	2011 Number of shares	2010 Number of shares	**2011 £m**	2010 £m
Sterling				
Ordinary shares of £1 each				
At 1 January	**1,574,285,751**	1,547,280,932	**1,574**	1,547
Shares issued on the transfer of HBOS[1]	**–**	21,394,458	**–**	21
Other share issues in 2010[2]	**–**	5,610,361	**–**	6
At 31 December	**1,574,285,751**	1,574,285,751	**1,574**	1,574

[1] As explained in note 31, on 1 January 2010, as part of a restructuring of the Lloyds Banking Group, Lloyds Banking Group plc's investment in 100 per cent of the ordinary share capital of HBOS plc was transferred to the Bank for a consideration of £21,394 million. The consideration was satisfied by the issue of 21,394,458 ordinary shares to Lloyds Banking Group plc.

[2] During 2010, the Bank issued a total of 5,610,361 ordinary shares as consideration for the redemption of certain preference shares and other subordinated liabilities issued by the Group.

Issued and fully paid preference shares

The Bank has in issue various classes of preference shares which are all classified as liabilities under IFRS and details of which are shown in note 45.

47 Share premium account

	Group and Bank	
	2011 £m	2010 £m
At 1 January	**35,533**	8,555
Premium arising on shares issued on the transfer of HBOS	**–**	21,373
Premium arising on other share issues in 2010	**–**	5,605
At 31 December	**35,533**	35,533

See note 46 for further details of share issues in 2011 and 2010.

48 Other reserves

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Other reserves comprise:				
Merger reserve	**6,348**	6,348	**–**	–
Revaluation reserve in respect of available-for-sale financial assets	**668**	(943)	**2,052**	259
Cash flow hedging reserve	**576**	(125)	**(12)**	(10)
Foreign currency translation reserve	**(92)**	(8)	**119**	116
At 31 December	**7,500**	5,272	**2,159**	365

Movements in other reserves were as follows:

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Merger reserve				
At 1 January	**6,348**	–	**–**	–
Reserve arising on transfer of HBOS (note 31)	**–**	6,348	**–**	–
At 31 December	**6,348**	6,348	**–**	–

Revaluation reserve in respect of available-for-sale financial assets

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
At 1 January	**(943)**	(1,441)	**259**	(399)
Change in fair value of available-for-sale financial assets	**2,603**	1,231	**2,708**	924
Deferred tax	**(673)**	(460)	**(669)**	(252)
Current tax	**–**	(8)	**(1)**	–
	1,930	763	**2,038**	672
Income statement transfers:				
Disposals (see note 9)	**(343)**	(399)	**(234)**	6
Deferred tax	**30**	106	**48**	(3)
	(313)	(293)	**(186)**	3
Impairment	**80**	114	**–**	21
Deferred tax	**29**	(5)	**–**	(6)
	109	109	**–**	15
Other transfers	**(155)**	(110)	**(78)**	(44)
Deferred tax	**40**	29	**19**	12
	(115)	(81)	**(59)**	(32)
At 31 December	**668**	(943)	**2,052**	259

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Cash flow hedging reserve				
At 1 January	**(125)**	(30)	**(10)**	(30)
Change in fair value of hedging derivatives	**893**	(1,062)	**(10)**	(13)
Deferred tax	**(249)**	277	**2**	(2)
Current tax	**–**	(3)	**–**	–
	644	(788)	**(8)**	(15)
Income statement transfer	**70**	932	**8**	41
Deferred tax	**(13)**	(239)	**(2)**	(6)
	57	693	**6**	35
At 31 December	**576**	(125)	**(12)**	(10)

48 Other reserves (continued)

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Foreign currency translation reserve				
At 1 January	**(8)**	129	**116**	99
Currency translation differences arising in the year	**(58)**	25	**3**	17
Foreign currency losses on net investment hedges (tax: nil)	**(26)**	(162)	**–**	–
At 31 December	**(92)**	(8)	**119**	116

49 Retained profits

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
At 1 January	**4,512**	4,660	**771**	1,051
(Loss) profit for the year[1]	**(868)**	(155)	**1,537**	(280)
Capital contribution	**2,340**	–	**2,340**	**–**
Employee share option schemes – value of employee services	**8**	7	**–**	–
At 31 December	**5,992**	4,512	**4,648**	771

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

50 Ordinary dividends

No dividends were paid on the Bank's ordinary shares in 2011 or 2010.

In November 2009, as part of the restructuring plan that was a requirement for European Commission approval of state aid received by the Lloyds Banking Group, Lloyds Banking Group plc agreed to suspend the payment of coupons and dividends on certain preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. Lloyds Banking Group plc has also agreed to temporarily suspend and/or waive dividend payments on certain preference shares which have been issued intra-group. Consequently, in accordance with the terms of some of these instruments, the Bank was prevented from making dividend payments on its ordinary shares during this period.

51 Share-based payments

Share-based payment scheme details

During the year ended 31 December 2011 Lloyds Banking Group plc operated a number of share-based payment schemes for which employees of the Lloyds TSB Bank Group were eligible and all of which are equity settled. Details of all schemes operated by Lloyds Banking Group are set out below; these are managed and operated on a Lloyds Banking Group-wide basis. The amount charged to the Group's income statement in respect of Lloyds Banking Group share-based payment schemes, and which is included within staff costs (note 11), was £376 million (2010: £541 million).

The amount charged to the Group's income statement in respect of Lloyds Banking Group share-based payment schemes, and which is included within staff costs (note 11), was £376 million (2010: £541 million).

Deferred bonus plans

Bonuses in respect of the performance in 2011 of employees within certain of the Group's bonus plans have been recognised in these financial statements in full.

Lloyds Banking Group executive share option schemes

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

Performance conditions for executive options

For options granted up to March 2001

The performance condition was that growth in earnings per share must be equal to the aggregate percentage change in the Retail Prices Index plus three percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking Group plc's ranking based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.

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

51 Share-based payments (continued)

For options granted from August 2001 to August 2004
The performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc.

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

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

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

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

For options granted in 2005
The same conditions applied as for grants made up to August 2004, except that:

– the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc;
– if the performance condition was not met at the end of the third subsequent year, the options would lapse; and
– the full grant of options became exercisable only if the Group was ranked in the top four places of the comparator group. A sliding scale applied between fourth and eighth positions. If Lloyds Banking Group was ranked below the median (ninth or below) the options would lapse.

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

Movements in the number of share options outstanding under the executive share option schemes during 2010 and 2011 are set out below:

	2011		2010	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**13,363,301**	**233.09**	8,784,978	476.56
Rebasement adjustment	**–**	**–**	7,523,547	(26.43)
Exercised	**–**	**–**	–	–
Forfeited	**(2,140,790)**	**225.91**	(2,945,224)	296.36
Lapsed	**(1,047,642)**	**324.92**	–	–
Outstanding at 31 December	**10,174,869**	**225.15**	13,363,301	233.09
Exercisable at 31 December	**10,174,869**	**225.15**	13,363,301	233.09

No options were exercised during 2011 or 2010. The weighted average remaining contractual life of options outstanding at the end of the year was 2.9 years (2010: 3.6 years).

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

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

	2011		2010	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**668,044,034**	**49.59**	130,133,992	177.60
Rebasement adjustment	**–**	**–**	22,382,641	(416.83)
Granted	**–**	**–**	655,712,663	46.78
Exercised	**(2,497,658)**	**47.34**	(195,339)	49.30
Forfeited	**(18,408,624)**	**50.52**	(13,922,185)	57.34
Cancelled	**(181,350,614)**	**47.78**	(107,144,275)	66.53
Expired	**(12,768,106)**	**69.08**	(18,923,463)	179.35
Outstanding at 31 December	**453,019,032**	**49.74**	668,044,034	49.59
Exercisable at 31 December	**25,490,233**	**77.82**	663,942	172.93

51 Share-based payments (continued)

The weighted average share price at the time that the options were exercised during 2011 was £0.54 (2010: £0.69). The weighted average remaining contractual life of options outstanding at the end of the year was 1.7 years (2010: 2.7 years).

No SAYE options were granted in 2011. The weighted average fair value of SAYE options granted during 2010 was £0.33. The values for the SAYE options have been determined using a standard Black-Scholes model.

For the HBOS sharesave plan, no options were exercised during 2011 or 2010. The options outstanding at 31 December 2011 had an exercise price of £1.8066 (2010: £1.8066) and a weighted average remaining contractual life of 2.0 years (2010: 2.9 years).

Other share option plans

Lloyds Banking Group Executive Share Plan 2003

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

	2011		2010	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**47,694,757**	**Nil**	26,099,185	Nil
Granted	**16,395,016**	**Nil**	13,429,561	Nil
Rebasement adjustment	–	–	12,501,246	Nil
Exercised	**(7,591,526)**	**Nil**	(2,661,703)	Nil
Forfeited	**(3,498,178)**	**Nil**	(1,673,532)	Nil
Outstanding at 31 December	**53,000,069**	**Nil**	47,694,757	Nil
Exercisable at 31 December	**2,310,418**	**Nil**	–	Nil

The weighted average fair value of options granted in the year was £0.46 (2010: £0.63). The weighted average share price at the time that the options were exercised during 2011 was £0.51 (2010: £0.63). The weighted average remaining contractual life of options outstanding at the end of the year was 2.1 years (2010: 2.4 years).

Lloyds Banking Group Share Buy Out Awards

As part of arrangements to facilitate the recruitment of certain Executives, options have been granted by individual deed and, where appropriate, in accordance with the Listing Rules of the UK Listing Authority.

The awards were granted in recognition that the Executives' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Group.

Movements in the number of options outstanding are set out below:

	2011	
	Number of options	**Weighted average exercise price (pence)**
Outstanding at 1 January	–	–
Granted	**21,728,172**	**Nil**
Exercised	**(406,935)**	**Nil**
Outstanding at 31 December	**21,321,237**	**Nil**
Exercisable at 31 December	**2,398,593**	**Nil**

The weighted average fair value of options granted in the year was £0.38. The weighted average share price at the time that the options were exercised during 2011 was £0.54. The weighted average remaining contractual life of options outstanding at the end of the year was 9.6 years.

51 Share-based payments (continued)

HBOS share option plans

The table below details the outstanding options for the HBOS Share Option Plan and the St James's Place Share Option Plan. The final award under the HBOS Share Option Plan was made in 2004. Under this plan, options over shares, at market value with a face value equal to 20 per cent of salary, were granted to employees with the exception of certain senior executives. A separate option plan exists for some partners of St James's Place, which granted options in respect of Lloyds Banking Group plc shares. The final award under the St James's Place Share Option Plan was made in 2009. Movements in the number of share options outstanding under these schemes are set out below:

	2011		2010	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**24,695,494**	**415.70**	14,301,748	880.27
Rebasement adjustment	**–**	**–**	12,899,990	(61.23)
Forfeited	**(213,498)**	**253.88**	(2,506,244)	611.90
Lapsed	**(2,423,444)**	**624.75**	–	–
Outstanding at 31 December	**22,058,552**	**394.30**	24,695,494	415.70
Exercisable at 31 December	**14,227,020**	**582.82**	15,320,780	593.79

No options were exercised during 2011 or 2010. The options outstanding under the HBOS Share Option Plan and St James's Place Share Option Plan at 31 December 2011 had exercise prices in the range of £0.5183 to £8.7189 (2010: £0.5183 to £8.7189) and a weighted average remaining contractual life of 2.0 years (2010: 3.0 years).

Other share plans

Lloyds Banking Group Long-Term Incentive Plan

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

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

(i) For 50 per cent of the award (the EPS Award) – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period needed to be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Prices Index over the same period. If it was less than 3 per cent per annum the EPS Award would lapse. If the increase was more than 3 per cent but less than 6 per cent per annum then the proportion of shares released would be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2008 and ended on 31 December 2010.

(ii) For the other 50 per cent of the award (the TSR Award) – it was necessary for the Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (13 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award would vest where the Group's total shareholder return was equal to median and vesting would occur on a straight line basis in between these points. Where the Group's total shareholder return was below the median of the comparator group, the TSR Award would lapse. The relevant period commenced on 6 March 2008 and ended on 5 March 2011.

In 2008, awards were made of 375 per cent of base salary to the Group Chief Executive and two of the Executive Directors for retention purposes, and in light of data reviewed by the Remuneration Committee which showed total remuneration to be behind median both for the FTSE 20, and the other major UK banks.

As a consequence of the acquisition of HBOS and the general market turmoil, in March 2009 the Remuneration Committee decided that the performance test for the 2008 awards should be based on the performance of the Group up to 17 September 2008, the date prior to the announcement of the HBOS acquisition. The performance test was on a fair value basis, on the estimated probability, as at that date, of achieving the performance conditions. As a consequence, for all participants, other than those who were Executive Directors at the time the award was granted and a small number of other senior executives, the share awards vested at 29 per cent in March 2011.

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

(i) **Earnings per share (EPS):** relevant to 50 per cent of the award. Performance will be measured based on EPS growth over a three-year period from the baseline EPS of 2008.

If the growth in EPS reaches 26 per cent, 25 per cent of this element of the award, being the threshold, will vest. If growth in EPS reaches 36 per cent, 100 per cent of this element will vest.

(ii) **Economic Profit (EP):** relevant to 50 per cent of the award. Performance will be measured based on the extent to which cumulative EP targets are achieved over the three-year period.

If the absolute improvement in adjusted EP reaches 100 per cent, 25 per cent of this element of the award, being the threshold, will vest. If the absolute improvement in adjusted EP reaches 202 per cent, 100 per cent of this element will vest.

The EPS and EP performance measures applying to this 2009 LTIP award were set on the basis that the Group would enter into the Government Asset Protection Scheme. As the Group is not participating in the Government Asset Protection Scheme, in June 2010 the Remuneration Committee approved restated performance measures on a basis consistent with the EPS and EP measures used for the 2010 LTIP awards.

51 Share-based payments (continued)

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

(i) **Synergy Savings:** The release of 50 per cent of the shares will be dependent on the achievement of target run-rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of at least £1.5 billion by the end of 2011. The award will be broken down into three equally weighted annual tranches. Performance will be assessed at the end of each year against annual performance targets based on a trajectory to meet the 2011 target. The extent to which targets have been achieved will determine the proportion of shares to be banked each year. Any release of shares will be subject to the Remuneration Committee judging the overall success of the delivery of the integration programme.

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

The performance conditions for awards made in March and August 2010 are as follows:

(i) **EPS**: relevant to 50 per cent of the award. Performance will be measured based on EPS growth over a three-year period from the baseline EPS of 2009.

If the absolute improvement in adjusted EPS reaches 158 per cent, 25 per cent of this element of the award, being the threshold, will vest. If absolute improvement in adjusted EPS reaches 180 per cent, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **EP:** relevant to 50 per cent of the award. Performance will be measured based on the compound annual growth rate of adjusted EP over the three financial years starting on 1 January 2010 relative to an adjusted 2009 EP base.

If the compounded annual growth rate of adjusted EP reaches 57 per cent per annum, 25 per cent of this element of the award, being the threshold, will vest. If the compounded annual growth rate of adjusted EP reaches 77 per cent per annum, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

For awards made to Executive Directors, a third performance condition was set, relating to Absolute Share Price, relevant to 28 per cent of the award. Performance will be measured based on the Absolute Share Price on 26 March 2013, being the third anniversary of the award date. If the share price at the end of the performance period is 75 pence or less, none of this element of the award will vest. If the share price is 114 pence or higher, 100 per cent of this element will vest. Vesting between threshold and maximum will be on a straight line basis, provided that shares comprised in the Absolute Share Price element may only be released if both the EPS and EP performance measures have been satisfied at the threshold level or above. The EPS and EP performance conditions will each relate to 36 per cent of the total award.

The performance conditions for awards made in March and September 2011 are as follows:

(i) **EPS:** relevant to 50 per cent of the award. The performance target is based on 2013 adjusted EPS outcome.

If the adjusted EPS reaches 6.4p, 25 per cent of this element of the award, being the threshold, will vest.

If adjusted EPS reaches 7.4p, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

(ii) **EP:** relevant to 50 per cent of the award. The performance target is based on 2013 adjusted EP outcome.

If the adjusted EP reaches £567 million, 25 per cent of this element of the award, being the threshold, will vest. If the adjusted EP reaches £1,234 million, 100 per cent of this element will vest.

Vesting between threshold and maximum will be on a straight line basis.

For awards made to Executive Directors, a third performance condition was set, relating to Absolute Total Shareholder Return, relevant to one third of the award. Performance will be measured based on the annualised Absolute Total Shareholder Return over the three year performance period. If the annualised Absolute Total Shareholder Return at the end of the performance period is less than 8 per cent, none of this element of the award will vest. If the Absolute Total Shareholder Return is 8 per cent, 25 per cent of this element of the award, being the threshold, will vest. If the Absolute Total Shareholder Return is 14 per cent or higher, 100 per cent of this element will vest. Vesting between threshold and maximum will be on a straight line basis. The EPS and EP performance conditions will each relate to 33.3 per cent of the total award.

	2011	2010
	Number of shares	Number of shares
Outstanding at 1 January	**447,142,491**	223,233,052
Granted	**147,280,077**	148,810,591
Rebasement adjustment	**–**	106,990,259
Vested	**(3,918,013)**	(1,985,339)
Forfeited	**(46,766,369)**	(29,906,072)
Outstanding at 31 December	**543,738,186**	447,142,491

The fair value of the share awards granted in 2011 was £0.54 (2010: £0.61).

51 Share-based payments (continued)

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

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**
31 December 2011									
Exercise price range									
£0 to £1	**–**	**–**	**–**	**47.94**	**1.7**	**446,965,447**	**4.94**	**4.1**	**82,152,838**
£1 to £2	**199.91**	**2.6**	**233,714**	**179.16**	**2.0**	**5,563,072**	**–**	**–**	**–**
£2 to £3	**225.74**	**2.9**	**9,941,155**	**214.16**	**0.9**	**490,513**	**–**	**–**	**–**
£3 to £4	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
£5 to £6	**–**	**–**	**–**	**–**	**–**	**–**	**582.82**	**1.8**	**14,227,020**

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2010									
Exercise price range									
£0 to £1	–	–	–	47.74	2.7	658,912,847	7.41	2.5	55,656,496
£1 to £2	199.91	3.6	262,725	178.74	2.8	7,984,764	–	–	–
£2 to £3	225.83	3.9	12,052,934	210.74	1.4	1,146,423	–	–	–
£3 to £4	324.92	0.2	1,047,642	–	–	–	–	–	–
£5 to £6	–	–	–	–	–	–	567.65	2.9	15,462,949

The fair value calculations at 31 December 2011 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Executive Share Plan 2003	**LTIP**	**Share Buy Out Awards**
Risk-free interest rate	**0.73%**	**1.77%**	**0.86%**
Expected life	**1.4 years**	**3.0 years**	**1.3 years**
Expected volatility	**54%**	**86%**	**51%**
Expected dividend yield	**1.7%**	**2.9%**	**1.6%**
Weighted average share price	**0.48**	**0.62**	**0.41**
Weighted average exercise price	**Nil**	**Nil**	**Nil**
Expected forfeitures	**4%**	**4%**	**4%**

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

Share incentive plan

Free shares

An award of shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000. The percentage is normally announced concurrently with the Group's annual results and the price of the shares awarded is announced at the time of award. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

The last award of free shares was made in 2008.

Matching shares

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

The number of shares awarded relating to matching shares in 2011 was 30,999,387 (2010: 17,411,651), with an average fair value of £0.42 (2010: £0.63), based on market prices at the date of award.

52 Related party transactions

Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the Group's key management personnel are the members of the Lloyds Banking Group plc Group Executive Committee together with its Non-Executive Directors.

As detailed in note 31, HBOS plc became a subsidiary of the Bank on 1 January 2010 and the compensation below reflects the increase in the amount of key management personnel time devoted to the Bank and its subsidiaries.

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

Compensation	2011 £m	2010 £m
Salaries and other short-term benefits	12	7
Post-employment benefits	–	2
Share-based payments	11	8
Total compensation	**23**	17

The aggregate of the emoluments of the directors was £8.5 million (2010: £10.6 million).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were four and two respectively (2010: three and two). Aggregate company contributions in respect of directors to defined contribution pension schemes were £167,000 (2010: £435,000).

The total for the highest paid director (António Horta-Osório) was £4,122,000 (2010: (J E Daniels) £2,572,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in either year.

Share options over Lloyds Banking Group plc shares	2011 £m	2010 £m
At 1 January	6	2
Granted, including certain adjustments (includes entitlements of appointed directors)[1]	20	4
Exercised/lapsed (includes entitlements of former directors)	(4)	–
At 31 December	**22**	6

[1] 2010 includes adjustments, using a standard HMRC formula, to negate the dilutionary impact of the Lloyds Banking Group's 2009 capital raising activities.

Share plans settled in Lloyds Banking Group plc shares	2011 £m	2010 £m
At 1 January	56	19
Granted, including certain adjustments (includes entitlements of appointed directors)[1]	35	39
Exercised/lapsed (includes 31 million entitlements of former directors)	(33)	(2)
At 31 December	**58**	56

[1] 2010 includes adjustments, using a standard HMRC formula, to negate the dilutionary impact of the Lloyds Banking Group's 2009 capital raising activities.

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

Loans	2011 £m	2010 £m
At 1 January	3	2
Advanced (includes loans of appointed directors)	1	2
Repayments (includes loans of former directors)	(1)	(1)
At 31 December	**3**	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 1.09 per cent and 27.5 per cent in 2011 (2010: 0.50 per cent and 17.90 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2010: £nil).

Deposits	2011 £m	2010 £m
At 1 January	4	4
Placed (includes deposits of appointed directors)	17	12
Withdrawn (includes deposits of former directors)	(15)	(12)
At 31 December	**6**	4

Deposits placed by key management personnel attracted interest rates of up to 5 per cent (2010: 4.25 per cent).

At 31 December 2011, the Group did not provide any guarantees in respect of key management personnel (2010 £nil).

52 Related party transactions (continued)

At 31 December 2011, transactions, arrangements and agreements entered into by the Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £3 million with four directors and three connected persons (2010: £2 million with six directors and four connected persons).

Balances and transactions with fellow Lloyds Banking Group undertakings

Balances and transactions between members of the Lloyds TSB Bank group

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

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

	2011 £m	2010 £m
Assets, included within:		
Derivative financial instruments	**6,750**	2,136
Loans and receivables:		
Loans and advances to banks	**162,569**	145,542
Loans and advances to customers	**49,303**	50,188
Available-for-sale financial assets	**5,027**	5,046
Other	**117**	–
	223,766	202,912
Liabilities, included within:		
Deposits from banks	**118,784**	80,476
Customer deposits	**39,462**	41,181
Derivative financial instruments	**4,464**	1,775
Debt securities in issue	**7,159**	5,167
Subordinated liabilities	**70**	37
Other	**64**	–
	170,003	128,636

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2011 the Bank earned interest income on the above asset balances of £2,833 million (2010: £2,176 million) and incurred interest expense on the above liability balances of £1,872 million (2010: £1,565 million).

In addition, the Bank raised recharges of £688 million (2010: £660 million) on its subsidiaries in respect of costs incurred and also received fees of £396 million (2010: £278 million), and paid fees of £365 million (2010: £387 million), for various services provided between the Bank and its subsidiaries.

Details of contingent liabilities and commitments entered into on behalf of fellow Lloyds Banking Group undertakings are given in note 53.

Balances and transactions with Lloyds Banking Group plc and fellow subsidiaries of the Bank

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Assets, included within:				
Loans and receivables:				
Loans and advances to customers	**18,599**	18,492	**14,056**	13,851
Other	**257**	36	**13**	36
	18,856	18,528	**14,069**	13,887
Liabilities, included within:				
Customer deposits	**10,546**	22,633	**4,045**	16,098
Derivative financial instruments	**489**	487	**488**	487
Subordinated liabilities	**12,747**	4,686	**12,477**	4,434
Debt securities in issue	**533**	–	**–**	–
	24,315	27,806	**17,010**	21,019

These balances include Lloyds Banking Group plc's banking arrangements and, due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2011 the Group earned £372 million and the Bank earned £338 million interest income on the above asset balances (2010: Group £373 million; Bank £321 million); the Group incurred £1,175 million and the Bank incurred £1,002 million interest expense on the above liability balances (2010: Group £1,215 million; Bank £950 million).

During the year, the Bank received a capital contribution from Lloyds Banking Group plc in the amount of £2,340 million (2010: £nil).

52 Related party transactions (continued)

UK Government

In January 2009, the UK Government through HM Treasury became a related party of Lloyds Banking Group plc, the Bank's ultimate parent company, following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2011, HM Treasury held a 40.2 per cent (31 December 2010: 40.6 per cent) interest in Lloyds Banking Group plc's ordinary share capital and consequently HM Treasury remained a related party of the Bank during the year ended 31 December 2011.

From 1 January 2011, in accordance with IAS 24 (Revised), UK Government-controlled entities became related parties of the Group. The Group regards the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

Since 1 January 2011, the Group has had the following significant transactions with the UK Government or UK Government-related entities:

Government and central bank facilities

During the year ended 31 December 2011, the Lloyds Banking Group participated in a number of schemes operated by the UK Government and central banks and made available to eligible banks and building societies.

Special liquidity scheme and credit guarantee scheme

The Bank of England's UK Special Liquidity Scheme was launched in April 2008 to allow financial institutions to swap temporarily illiquid assets for treasury bills, with fees charged based on the spread between 3-month LIBOR and the 3-month gilt repo rate. The scheme will operate for up to three years after the end of the drawdown period (30 January 2009) at the Bank of England's discretion. At 31 December 2011, the Lloyds Banking Group did not utilise the Special Liquidity Scheme.

HM Treasury launched the Credit Guarantee Scheme in October 2008 as part of a range of measures announced by the UK Government intended to ease the turbulence in the UK banking system. It charged a commercial fee for the guarantee of new short and medium term debt issuance. The fee payable to HM Treasury on guaranteed issues was based on a per annum rate of 50 basis points plus the median five-year credit default swap spread. The drawdown window for the Credit Guarantee Scheme closed for new issuance at the end of February 2010. At 31 December 2011, the Lloyds Banking Group had £23.5 billion of debt in issue under the Credit Guarantee Scheme (31 December 2010: £45.4 billion). During the year, fees of £28 million paid to HM Treasury in respect of guaranteed funding were included in the Lloyds Banking Group's income statement.

Lending commitments

The formal lending commitments entered into in connection with the Group's proposed participation in the Government Asset Protection Scheme have now expired and in February 2011, Lloyds Banking Group plc (together with Barclays, Royal Bank of Scotland, HSBC and Santander) announced, as part of the 'Project Merlin' agreement with HM Treasury, its capacity and willingness to increase business lending (including to small and medium-sized enterprises) during 2011.

Business Growth Fund

In May 2011 Lloyds Banking Group agreed, together with The Royal Bank of Scotland plc (and three other non-related parties), to subscribe for shares in the Business Growth Fund plc which is the company created to fulfil the role of the Business Growth Fund as set out in the British Bankers' Association's Business Taskforce Report of October 2010. During 2011, the Lloyds Banking Group has incurred sunk costs of £4 million which have been written off. As at 31 December 2011, the Lloyds Banking Group's investment in the Business Growth fund was £20 million.

Other government-related entities

Other than the transactions referred to above, there were no other significant transactions with the UK Government and UK Government-controlled entities (including UK Government-controlled banks) during the period that were not made in the ordinary course of business or that were unusual in their nature or conditions.

Other related party transactions

Pension funds

The Group provides banking and some investment management services to certain of the Group pension funds. At 31 December 2011, customer deposits of £63 million (2010: £64 million) and investment and insurance contract liabilities of £928 million (2010: £850 million) related to the Group's pension funds. During 2011, the Group sold at fair value certain non-government bonds, equities and alternative assets to Lloyds TSB Group Pension Scheme No 1 for £336 million and to Lloyds TSB Group Pension Scheme No 2 for £67 million.

Open Ended Investment Companies (OEICs)

The Group manages 249 (2010: 402) Open Ended Investment Companies (OEICs), and of these 142 (2010: 111) are consolidated. The Group invested £1,283 million (2010: £1,460 million) and redeemed £884 million (2010: £982 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £4,431 million (2010: £7,920 million) at 31 December. The Group earned fees of £318 million from the unconsolidated OEICs (2010: £271 million).

Taxation

Group relief was surrendered for no payment as per note 15.

Joint ventures and associates

The Group provides both administration and processing services to its principal joint venture, Sainsbury's Bank plc. The amounts receivable by the Group during the year were £21 million (2010: £31 million), of which £10 million was outstanding at 31 December 2011 (2010: £8 million). At 31 December 2011, Sainsbury's Bank plc also had balances with the Group that were included in loans and advances to banks of £1,173 million (2010: £1,277 million), deposits by banks of £780 million (2010: £1,358 million) and trading liabilities of £340 million (2010: nil).

At 31 December 2011 there were loans and advances to customers of £5,185 million (2010: £5,660 million) outstanding and balances within customer deposits of £88 million (2010: £151 million) relating to other joint ventures and associates.

In addition to the above balances, the Group has a number of other associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2011, these companies had total assets of approximately £11,500 million (2010: £12,216 million), total liabilities of approximately £10,807 million (2010: £11,937 million) and for the year ended 31 December 2011 had turnover of approximately £7,376 million (2010: £3,829 million) and made a net loss of approximately £83 million (2010: net profit of approximately £182 million). In addition, the Group has provided £5,767 million (2010: £3,316 million) of financing to these companies on which it received £106 million (2010: £93 million) of interest income in the year.

53 Contingent liabilities and commitments

Interchange fees
The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard set a uniform Multilateral Interchange Fee (MIF) in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the MIF be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the General Court of the European Union (the General Court). Lloyds TSB Bank plc and Bank of Scotland plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of the MIF are compatible with European Union competition laws. The UK Government has also intervened in the General Court appeal supporting the European Commission position. An oral hearing took place on 8 July 2011 but judgment is not expected for six to twelve months. MasterCard has reached an understanding with the European Commission on a new methodology for calculating intra-European Economic Area MIF on an interim basis pending the outcome of the appeal.

Meanwhile, the European Commission is pursuing an investigation with a view to deciding whether arrangements adopted by Visa for the levying of the MIF in respect of cross-border payment transactions also infringe European Union competition laws. In this regard Visa reached an agreement with the European Commission to reduce the level of interchange for cross-border debit card transactions to the interim levels agreed by MasterCard. The UK's Office of Fair Trading has also commenced similar investigations relating to the MIF in respect of domestic transactions in relation to both the MasterCard and Visa payment schemes. The ultimate impact of the investigations on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

Interbank offered rate setting investigations
Several government agencies in the UK, US and overseas, including the US Commodity Futures Trading Commission, the US SEC, the US Department of Justice and the FSA as well as the European Commission, are conducting investigations into submissions made by panel members to the bodies that set various interbank offered rates. The Group, and/or its subsidiaries, were (at the relevant time) and remain members of various panels that submit data to these bodies. The Group has received requests from some government agencies for information and is co-operating with their investigations. In addition, the Group has been named in private lawsuits, including purported class action suits in the US with regard to the setting of London interbank offered rates (LIBOR). It is currently not possible to predict the scope and ultimate outcome of the various regulatory investigations or private lawsuits, including the timing and scale of the potential impact of any investigations and private lawsuits on the Group.

Financial Services Compensation Scheme (FSCS)
The FSCS is the UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by levies on the industry (and recoveries and borrowings where appropriate). The levies raised comprise both management expenses levies and, where necessary, compensation levies on authorised firms.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. The borrowings with HM Treasury, which total circa £20 billion, are on an interest-only basis until 31 March 2012 and the FSCS and HM Treasury are currently discussing the terms for refinancing these borrowings to take effect from 1 April 2012. Each deposit-taking institution contributes towards the management expenses levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March. In determining an appropriate accrual in respect of the management expenses levy, certain assumptions have been made including the proportion of total protected deposits held by the Group, the level and timing of repayments to be made by the FSCS to HM Treasury and the interest rate to be charged by HM Treasury. For the year ended 31 December 2011, the Group has charged £179 million (2010: £46 million) to the income statement in respect of the costs of the FSCS.

Whilst it is expected that the substantial majority of the principal will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, to the extent that there remains a shortfall, the FSCS will raise compensation levies on all deposit-taking participants. The amount of any future compensation levies also depends on a number of factors including the level of protected deposits and the population of deposit-taking participants and will be determined at a later date. As such, although the Group's share of such compensation levies could be significant, the Group has not recognised a provision in respect of them in these financial statements.

Litigation in relation to insurance branch business in Germany
Clerical Medical Investment Group Limited (CMIG) has received a number of claims in the German courts, relating to policies issued by CMIG but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. CMIG has won the majority of decisions to date, although a small number of regional district and appeal courts have found against CMIG on specific grounds. CMIG's strategy includes defending claims robustly and appealing against adverse judgments. The ultimate financial effect, which could be significant, will only be known once all relevant claims have been resolved. However, consistent with this strategy, and having regard to the costs involved in managing these claims, and the inherent risks of litigation, the Group has recognised a provision of £175 million. Management believes this represents the most appropriate estimate of the financial impact, based upon a series of assumptions, including the number of claims received, the proportion upheld, and resulting legal and administration costs.

Shareholder complaints
Lloyds Banking Group plc and two former members of Lloyds Banking Group plc's Board of Directors have been named as defendants in a purported securities class action pending in the United States District Court for the Southern District of New York. The complaint, dated 23 November 2011, asserts claims under the Securities Exchange Act of 1934 in connection with alleged material omissions from statements made in 2008 in connection with the acquisition of HBOS by Lloyds Banking Group plc. No quantum is specified.

In addition, a UK-based shareholder action group has threatened multi-claimant claims on a similar basis against the Lloyds Banking Group plc and two former directors in the UK. No claim has yet been issued.

Lloyds Banking Group plc considers that the claims are without merit and will defend them vigorously. The claims have not been quantified and it is not possible to estimate the ultimate financial impact on Lloyds Banking Group plc or the Group at this early stage.

Employee disputes
The Group is aware that a union representing a number of the Group's employees and former employees is seeking to challenge the cap on pensionable pay introduced by the Group in 2011 on the grounds that it is unlawful. This challenge is at a very early stage. The Group will resist the challenge should it be pursued.

The Group also faces a number of other threats of legal action from employees in relation to terms of employment including pay and bonuses. The Group considers that the complaints are without merit and, should proceedings be issued, they will be vigorously defended.

53 Contingent liabilities and commitments (continued)

FSA investigation into Bank of Scotland plc
In 2009 the FSA commenced a supervisory review into HBOS. The supervisory review has now been superseded as the FSA has commenced enforcement proceedings against Bank of Scotland plc in relation to its Corporate division pre 2009. The proceedings are ongoing and the Group is co-operating fully. It is too early to predict the outcome or estimate reliably any potential financial effects of the enforcement proceedings but they are not currently expected to be material to the Group.

Regulatory matters
In the course of its business, the Group is engaged in discussions with the FSA in relation to a range of conduct of business matters, including complaints handling, packaged bank accounts, savings accounts, product terms and conditions, interest-only mortgages, sales processes and remuneration schemes. The Group is keen to ensure that any regulatory concerns are understood and addressed. The ultimate impact on the Group of these discussions can only be known at the conclusion of such discussions.

Other legal actions and regulatory matters
In addition, during the ordinary course of business the Group is subject to other threatened and actual legal proceedings (which may include class action lawsuits brought on behalf of customers, shareholders or other third parties), regulatory investigations, regulatory challenges and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed properly to assess the merits of the case and no provisions are held against such matters. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position.

Contingent liabilities and commitments arising from the banking business
Acceptances and endorsements arise where the Group or the Bank agrees to guarantee payment on a negotiable instrument drawn up by a customer.

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

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

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Contingent liabilities				
Acceptances and endorsements	**81**	48	**80**	50
Other:				
Other items serving as direct credit substitutes	**1,060**	1,319	**959**	1,154
Performance bonds and other transaction-related contingencies	**2,729**	2,812	**2,117**	2,280
	3,789	4,131	**3,076**	3,434
Total contingent liabilities	**3,870**	4,179	**3,156**	3,484

	The Bank	
	2011 £m	2010 £m
Incurred on behalf of fellow Lloyds Banking Group undertakings	**83**	69

53 Contingent liabilities and commitments (continued)

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Commitments				
Documentary credits and other short-term trade-related transactions	**105**	255	**97**	259
Forward asset purchases and forward deposits placed	**596**	887	**596**	1,705
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year original maturity:				
Mortgage offers made	**7,383**	8,113	**901**	1,043
Other commitments	**56,527**	60,528	**32,511**	38,216
	63,910	68,641	**33,412**	39,259
1 year or over original maturity	**40,972**	47,515	**42,487**	41,976
Total commitments	**105,583**	117,298	**76,592**	83,199

	The Bank	
	2011 £m	2010 £m
Incurred on behalf of fellow Lloyds Banking Group undertakings	**9,504**	14,008

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £53,459 million (2010: £63,630 million) for the Group and £36,831 million (2010: £39,280 million) for the Bank were irrevocable.

Operating lease commitments

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Not later than 1 year	**348**	356	**187**	172
Later than 1 year and not later than 5 years	**1,187**	1,120	**640**	479
Later than 5 years	**1,489**	1,706	**606**	561
Total operating lease commitments	**3,024**	3,182	**1,433**	1,212

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

Capital commitments

Excluding commitments of the Group in respect of investment property (note 26), capital expenditure contracted but not provided for at 31 December 2011 amounted to £296 million (2010: £339 million) for the Group and £4 million (2010: £12 million) for the Bank. Of this amount for the Group, £292 million (2010: £282 million) relates to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

54 Financial instruments

(1) Measurement basis of financial assets and liabilities

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

		At fair value through profit or loss						
The Group	Derivatives designated as hedging instruments £m	Held for trading £m	Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2011								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	60,722	–	60,722
Items in the course of collection from banks	–	–	–	–	–	1,408	–	1,408
Trading and other financial assets at fair value through profit or loss	–	18,068	121,175	–	–	–	–	139,243
Derivative financial instruments	13,913	50,929	–	–	–	–	–	64,842
Loans and receivables:								
Loans and advances to banks	–	–	–	–	32,606	–	–	32,606
Loans and advances to customers	–	–	–	–	584,237	–	–	584,237
Debt securities	–	–	–	–	12,470	–	–	12,470
	–	–	–	–	629,313	–	–	629,313
Available-for-sale financial assets	–	–	–	37,952	–	–	–	37,952
Held-to-maturity investments	–	–	–	–	–	8,098	–	8,098
Total financial assets	13,913	68,997	121,175	37,952	629,313	70,228	–	941,578
Financial liabilities								
Deposits from banks	–	–	–	–	–	39,810	–	39,810
Customer deposits	–	–	–	–	–	424,377	–	424,377
Items in course of transmission to banks	–	–	–	–	–	844	–	844
Trading and other financial liabilities at fair value through profit or loss	–	19,616	5,339	–	–	–	–	24,955
Derivative financial instruments	7,246	51,455	–	–	–	–	–	58,701
Notes in circulation	–	–	–	–	–	1,145	–	1,145
Debt securities in issue	–	–	–	–	–	184,504	–	184,504
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	79,001	79,001
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	49,636	49,636
Unallocated surplus within insurance businesses	–	–	–	–	–	–	300	300
Financial guarantees	–	–	49	–	–	–	–	49
Subordinated liabilities	–	–	–	–	–	37,330	–	37,330
Total financial liabilities	7,246	71,071	5,388	–	–	688,010	128,937	900,652

54 Financial instruments (continued)

The Group	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2010								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	38,115	–	38,115
Items in the course of collection from banks	–	–	–	–	–	1,368	–	1,368
Trading and other financial assets at fair value through profit or loss	–	23,743	132,533	–	–	–	–	156,276
Derivative financial instruments	7,406	42,194	–	–	–	–	–	49,600
Loans and receivables:								
Loans and advances to banks	–	–	–	–	30,272	–	–	30,272
Loans and advances to customers	–	–	–	–	611,089	–	–	611,089
Debt securities	–	–	–	–	25,735	–	–	25,735
	–	–	–	–	667,096	–	–	667,096
Available-for-sale financial assets	–	–	–	42,955	–	–	–	42,955
Held-to-maturity investments	–	–	–	–	–	7,905	–	7,905
Total financial assets	7,406	65,937	132,533	42,955	667,096	47,388	–	963,315
Financial liabilities								
Deposits from banks	–	–	–	–	–	50,363	–	50,363
Customer deposits	–	–	–	–	–	416,276	–	416,276
Items in course of transmission to banks	–	–	–	–	–	802	–	802
Trading and other financial liabilities at fair value through profit or loss	–	20,097	6,665	–	–	–	–	26,762
Derivative financial instruments	4,398	38,247	–	–	–	–	–	42,645
Notes in circulation	–	–	–	–	–	1,074	–	1,074
Debt securities in issue	–	–	–	–	–	228,317	–	228,317
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	80,749	80,749
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	51,363	51,363
Unallocated surplus within insurance businesses	–	–	–	–	–	–	643	643
Financial guarantees	–	–	54	–	–	–	–	54
Subordinated liabilities	–	–	–	–	–	29,609	–	29,609
Total financial liabilities	4,398	58,344	6,719	–	–	726,441	132,755	928,657

54 Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2011							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	57,500	57,500
Items in the course of collection from banks	–	–	–	–	–	898	898
Trading and other financial assets at fair value through profit or loss	–	4,084	581	–	–	–	4,665
Derivative financial instruments	3,659	33,858	–	–	–	–	37,517
Loans and receivables:							
Loans and advances to banks	–	–	–	–	167,896	–	167,896
Loans and advances to customers	–	–	–	–	249,113	–	249,113
Debt securities	–	–	–	–	633	–	633
	–	–	–	–	417,642	–	417,642
Available-for-sale financial assets	–	–	–	31,351	–	–	31,351
Held-to-maturity investments	–	–	–	–	–	8,098	8,098
Total financial assets	3,659	37,942	581	31,351	417,642	66,496	557,671
Financial liabilities							
Deposits from banks	–	–	–	–	–	154,592	154,592
Customer deposits	–	–	–	–	–	227,553	227,553
Items in course of transmission to banks	–	–	–	–	–	487	487
Trading and other financial liabilities at fair value through profit or loss	–	5,566	5,339	–	–	–	10,905
Derivative financial instruments	905	34,126	–	–	–	–	35,031
Debt securities in issue	–	–	–	–	–	102,237	102,237
Financial guarantees	–	–	32	–	–	–	32
Subordinated liabilities	–	–	–	–	–	25,045	25,045
Total financial liabilities	905	39,692	5,371	–	–	509,914	555,882

54 Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2010							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	35,585	35,585
Items in the course of collection from banks	–	–	–	–	–	997	997
Trading and other financial assets at fair value through profit or loss	–	3,526	1,061	–	–	–	4,587
Derivative financial instruments	956	20,366	–	–	–	–	21,322
Loans and receivables:							
Loans and advances to banks	–	–	–	–	152,596	–	152,596
Loans and advances to customers	–	–	–	–	251,173	–	251,173
Debt securities	–	–	–	–	1,479	–	1,479
	–	–	–	–	405,248	–	405,248
Available-for-sale financial assets	–	–	–	24,951	–	–	24,951
Held-to-maturity investments	–	–	–	–	–	7,905	7,905
Total financial assets	956	23,892	1,061	24,951	405,248	44,487	500,595
Financial liabilities							
Deposits from banks	–	–	–	–	–	118,337	118,337
Customer deposits	–	–	–	–	–	223,812	223,812
Items in course of transmission to banks	–	–	–	–	–	506	506
Trading and other financial liabilities at fair value through profit or loss	–	4,603	6,665	–	–	–	11,268
Derivative financial instruments	678	19,582	–	–	–	–	20,260
Debt securities in issue	–	–	–	–	–	115,122	115,122
Financial guarantees	–	–	42	–	–	–	42
Subordinated liabilities	–	–	–	–	–	15,574	15,574
Total financial liabilities	678	24,185	6,707	–	–	473,351	504,921

(2) Reclassification of financial assets

In 2010 the Group reviewed its approach to managing a portfolio of government securities held as a separately identifiable component of the Group's liquidity portfolio. Given the long-term nature of this portfolio, the Group concluded that certain of these securities will be able to be held until they reach maturity. Consequently, on 31 October 2010, government securities with a fair value of £3,601 million, which are held by the Bank, were reclassified from available-for-sale financial assets to held-to-maturity investments reflecting the Group's positive intent and ability to hold them until maturity.

In 2009, no financial assets were reclassified.

In 2008, in accordance with the amendment to IAS39 that became applicable during that year, the Group reviewed the categorisation of its financial assets classified as held for trading and available-for-sale. On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, with effect from 1 July 2008, the Group transferred £2,993 million of assets previously classified as held for trading into loans and receivables. With effect from 1 November 2008, the Group transferred £437 million of assets previously classified as available-for-sale financial assets into loans and receivables. At the time of these transfers, the Group had the intention and ability to hold them for the foreseeable future or until maturity. As at the date of reclassification, the weighted average effective interest rate of the assets transferred was 6.3 per cent with the estimated recoverable cash flows of £3,524 million.

Carrying value and fair value of reclassified assets

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

	31 December 2011		31 December 2010		31 December 2009		31 December 2008	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
From held for trading to loans and receivables	**67**	**56**	750	727	1,833	1,822	2,883	2,926
From available-for-sale financial assets to loans and receivables	**217**	**219**	313	340	394	422	454	402
From available-for-sale financial assets to held-to-maturity investments	**3,624**	**3,846**	3,455	3,539	–	–	–	–
Total carrying value and fair value	**3,908**	**4,121**	4,518	4,606	2,227	2,244	3,337	3,328

During the year ended 31 December 2011, the carrying value of the assets reclassified to loans and receivables decreased by £779 million (2010: £1,164 million) due to sales and maturities of £734 million (2010: £1,220 million), foreign exchange and other movements of £58 million (£22 million) less accretion of discount of £13 million (2010: £34 million).

54 Financial instruments (continued)

In respect of government securities reclassified from available-for-sale financial assets to held-to-maturity investments, there was no change in the amounts recognised in the Group's income statement as interest income (2011: £138 million; 2010: £23 million) and, for relevant securities, foreign exchange gains and losses (2011: £14 million loss; 2010: £39 million gain) as such items are recognised in profit or loss on the same basis.

No financial assets were reclassified in accordance with paragraphs 50B, 50D or 50E of IAS 39 in 2011, 2010 and 2009; the following disclosures relate to those assets which were so reclassified in 2008.

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

	2011 £m	2010 £m	2009 £m	2008 £m
From held for trading to loans and receivables	**(3)**	(34)	208	(347)

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

	2011 £m	2010 £m	2009 £m	2008 £m
From available-for-sale financial assets to loans and receivables	**(68)**	69	161	(108)

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

	2011 £m	2010 £m	2009 £m	2008 £m
From held for trading to loans and receivables:				
Net interest income	**1**	24	55	31
Impairment losses	**–**	(6)	(49)	(158)
Total amounts recognised	**1**	18	6	(127)

	2011 £m	2010 £m	2009 £m	2008 £m
From available-for-sale financial assets to loans and receivables:				
Net interest income	**2**	1	34	3
Impairment losses	**(8)**	(2)	(56)	(23)
Total amounts recognised	**(6)**	(1)	(22)	(20)

54 Financial instruments (continued)

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

	The Group				The Bank			
	2011		2010		**2011**		2010	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets								
Cash and balances at central banks	**60,722**	**60,722**	38,115	38,115	**57,500**	**57,500**	35,585	35,585
Items in the course of collection from banks	**1,408**	**1,408**	1,368	1,368	**898**	**898**	997	997
Trading and other financial assets at fair value through profit or loss	**139,243**	**139,243**	156,276	156,276	**4,665**	**4,665**	4,587	4,587
Derivative financial instruments	**64,842**	**64,842**	49,600	49,600	**37,517**	**37,517**	21,322	21,322
Loans and receivables:								
Loans and advances to banks	**32,606**	**32,554**	30,272	30,236	**167,896**	**167,870**	152,596	152,553
Loans and advances to customers	**584,237**	**568,428**	611,089	598,835	**249,113**	**243,910**	251,173	248,656
Debt securities	**12,470**	**10,953**	25,735	27,102	**633**	**749**	1,479	1,380
	629,313	**611,935**	667,096	656,173	**417,642**	**412,529**	405,248	402,589
Available-for-sale financial assets	**37,952**	**37,952**	42,955	42,955	**31,351**	**31,351**	24,951	24,951
Held-to-maturity investments	**8,098**	**8,144**	7,905	7,716	**8,098**	**8,144**	7,905	7,716
Financial liabilities								
Deposits from banks	**39,810**	**40,012**	50,363	50,520	**154,592**	**154,696**	118,337	118,027
Customer deposits	**424,377**	**425,125**	416,276	417,036	**227,553**	**227,385**	223,812	223,262
Items in course of transmission to banks	**844**	**844**	802	802	**487**	**487**	506	506
Trading and other financial liabilities at fair value through profit or loss	**24,955**	**24,955**	26,762	26,762	**10,905**	**10,905**	11,268	11,268
Derivative financial instruments	**58,701**	**58,701**	42,645	42,645	**35,031**	**35,031**	20,260	20,260
Notes in circulation	**1,145**	**1,145**	1,074	1,074	**–**	**–**	–	–
Debt securities in issue	**184,504**	**182,558**	228,317	228,826	**102,237**	**100,468**	115,122	115,067
Liabilities arising from non-participating investment contracts	**49,636**	**49,636**	51,363	51,363	**–**	**–**	–	–
Financial guarantees	**49**	**49**	54	54	**32**	**32**	42	42
Subordinated liabilities	**37,330**	**33,047**	29,609	32,909	**25,045**	**23,388**	15,574	15,088

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

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

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

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

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

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

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

54 Financial instruments (continued)

Fair value of financial instruments carried at amortised cost

Cash and balances at central banks and items in the course of collection from banks
The fair value approximates carrying value due to their short-term nature.

Loans and receivables
The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. These techniques also take account of expected credit losses and changes in interest rates and expected future cash flows in establishing fair value. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair values of asset-backed securities and secondary loans, which were previously within assets held for trading and were reclassified to loans and receivables (see page 104), are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

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

Items in course of transmission to banks
The fair value approximates carrying value due to their short-term nature.

Notes in circulation
The fair value of notes in circulation which are payable on demand is considered to be equal to their carrying value.

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

Held-to-maturity investments
The fair values of government securities are based on market prices.

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

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

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

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

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

54 Financial instruments (continued)

Valuation hierarchy

The Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
At 31 December 2011				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	9,766	–	9,766
Loans and advances to banks	–	1,355	–	1,355
Debt securities:				
Government securities	21,326	2,041	–	23,367
Other public sector securities	375	808	–	1,183
Bank and building society certificates of deposit	–	3,248	–	3,248
Asset-backed securities:				
Mortgage-backed securities	187	524	–	711
Other asset-backed securities	178	1,605	203	1,986
Corporate and other debt securities	5,098	15,048	1,423	21,569
	27,164	23,274	1,626	52,064
Equity shares	74,403	41	1,315	75,759
Treasury and other bills	299	–	–	299
Total trading and other financial assets at fair value through profit or loss	101,866	34,436	2,941	139,243
Available-for-sale financial assets				
Debt securities:				
Government securities	25,143	93	–	25,236
Other public sector securities	27	–	–	27
Bank and building society certificates of deposit	323	43	–	366
Asset-backed securities:				
Mortgage-backed securities	–	1,803	–	1,803
Other asset-backed securities	–	807	257	1,064
Corporate and other debt securities	41	5,738	12	5,791
	25,534	8,484	269	34,287
Equity shares	55	96	1,787	1,938
Treasury and other bills	972	755	–	1,727
Total available-for-sale financial assets	26,561	9,335	2,056	37,952
Derivative financial instruments	204	63,161	1,477	64,842
Total financial assets carried at fair value	128,631	106,932	6,474	242,037
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss (debt securities)	–	5,339	–	5,339
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	12,378	–	12,378
Short positions in securities	3,168	533	–	3,701
Other	–	3,537	–	3,537
	3,168	16,448	–	19,616
Total trading and other financial liabilities at fair value through profit or loss	3,168	21,787	–	24,955
Derivative financial instruments	35	57,925	741	58,701
Financial guarantees	–	–	49	49
Total financial liabilities carried at fair value	3,203	79,712	790	83,705

54 Financial instruments (continued)

The Group At 31 December 2010	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	9,811	–	9,811
Loans and advances to banks	–	2,734	–	2,734
Debt securities:				
Government securities	21,053	2,787	–	23,840
Other public sector securities	199	720	–	919
Bank and building society certificates of deposit	–	4,298	–	4,298
Asset-backed securities:				
Mortgage-backed securities	2	420	–	422
Other asset-backed securities	5	2,324	283	2,612
Corporate and other debt securities	2,936	17,023	1,186	21,145
	24,195	27,572	1,469	53,236
Equity shares	88,855	46	1,367	90,268
Treasury and other bills	227	–	–	227
Total trading and other financial assets at fair value through profit or loss	113,277	40,163	2,836	156,276
Available-for-sale financial assets				
Debt securities:				
Government securities	11,517	1,035	–	12,552
Other public sector securities	29	–	–	29
Bank and building society certificates of deposit	15	392	–	407
Asset-backed securities:				
Mortgage-backed securities	–	4,293	–	4,293
Other asset-backed securities	–	4,640	579	5,219
Corporate and other debt securities	711	11,399	22	12,132
	12,272	21,759	601	34,632
Equity shares	49	161	2,045	2,255
Treasury and other bills	2,160	3,908	–	6,068
Total available-for-sale financial assets	14,481	25,828	2,646	42,955
Derivative financial instruments	985	47,805	810	49,600
Total financial assets carried at fair value	128,743	113,796	6,292	248,831
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss (debt securities)	–	6,665	–	6,665
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	14,612	–	14,612
Short positions in securities	861	894	–	1,755
Other	3	3,727	–	3,730
	864	19,233	–	20,097
Total trading and other financial liabilities at fair value through profit or loss	864	25,898	–	26,762
Derivative financial instruments	42	42,400	203	42,645
Financial guarantees	–	–	54	54
Total financial liabilities carried at fair value	906	68,298	257	69,461

There were no significant transfers between level 1 and level 2 during the year.

54 Financial instruments (continued)

Valuation hierarchy

The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
At 31 December 2011				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	69	–	69
Debt securities:				
Government securities	1,008	–	–	1,008
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	1,479	–	1,479
Asset-backed securities:				
Mortgage-backed securities	–	99	–	99
Other asset-backed securities	–	19	–	19
Corporate and other debt securities	–	1,900	–	1,900
	1,008	3,497	–	4,505
Equity shares	4	12	–	16
Treasury and other bills	75	–	–	75
Total trading and other financial assets at fair value through profit or loss	1,087	3,578	–	4,665
Available-for-sale financial assets				
Debt securities:				
Government securities	25,067	–	–	25,067
Other public sector securities	27	–	–	27
Bank and building society certificates of deposit	323	6	–	329
Asset-backed securities:				
Mortgage-backed securities	–	497	–	497
Other asset-backed securities	–	152	153	305
Corporate and other debt securities	–	5,050	–	5,050
	25,417	5,705	153	31,275
Equity shares	4	43	–	47
Treasury and other bills	20	9	–	29
Total available-for-sale financial assets	25,441	5,757	153	31,351
Derivative financial instruments	3	36,389	1,125	37,517
Total financial assets carried at fair value	26,531	45,724	1,278	73,533
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss (debt securities)	–	5,339	–	5,339
Trading liabilities:				
Short positions in securities	1,431	533	–	1,964
Other	–	3,602	–	3,602
	1,431	4,135	–	5,566
Total trading and other financial liabilities at fair value through profit or loss	1,431	9,474	–	10,905
Derivative financial instruments	3	34,322	706	35,031
Financial guarantees	–	–	32	32
Total financial liabilities carried at fair value	1,434	43,796	738	45,968

54 Financial instruments (continued)

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2010				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	325	–	325
Debt securities:				
Government securities	133	100	–	233
Asset-backed securities:				
Other asset-backed securities	–	1	93	94
Corporate and other debt securities	208	3,698	–	3,906
	341	3,799	93	4,233
Equity shares	–	29	–	29
Total trading and other financial assets at fair value through profit or loss	341	4,153	93	4,587
Available-for-sale financial assets				
Debt securities:				
Government securities	12,398	7	–	12,405
Other public sector securities	29	–	–	29
Bank and building society certificates of deposit	15	257	–	272
Asset-backed securities:				
Mortgage-backed securities	–	971	–	971
Other asset-backed securities	–	883	371	1,254
Corporate and other debt securities	–	6,023	–	6,023
	12,442	8,141	371	20,954
Equity shares	–	73	–	73
Treasury and other bills	16	3,908	–	3,924
Total available-for-sale financial assets	12,458	12,122	371	24,951
Derivative financial instruments	2	20,776	544	21,322
Total financial assets carried at fair value	12,801	37,051	1,008	50,860
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss (debt securities)	–	6,665	–	6,665
Trading liabilities:				
Short positions in securities	–	894	–	894
Other	–	3,709	–	3,709
	–	4,603	–	4,603
Total trading and other financial liabilities at fair value through profit or loss	–	11,268	–	11,268
Derivative financial instruments	2	20,089	169	20,260
Financial guarantees	–	–	42	42
Total financial liabilities carried at fair value	2	31,357	211	31,570

54 Financial instruments (continued)

Valuation methodology

Asset-backed securities

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

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.

Unquoted equities and property partnerships in the life funds

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

Derivatives

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

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

Complex interest rate and foreign exchange products where there is significant dispersion of consensus pricing or where implied funding costs are material and unobservable are classified as level 3.

Where credit protection, usually in the form of credit default swaps, has been purchased or written on asset-backed securities, the security is referred to as a negative basis asset-backed security and the resulting derivative assets or liabilities have been classified as either level 2 or level 3 according to the classification of the underlying asset-backed security.

Level 3 derivative assets also include £14 million (31 December 2010: £96 million) in respect of credit default swaps written on level 3 negative basis asset-backed securities calculated as set out in the table below:

	2011 £m	2010 £m
Fair value before credit valuation adjustment	**18**	114
Less: credit valuation adjustment	**(4)**	(18)
Carrying value	**14**	96

54 Financial instruments (continued)

Movements in level 3 portfolio

The table below analyses movements in the level 3 financial assets portfolio:

The Group	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Derivative assets £m	Total financial assets £m
At 1 January 2010	1,591	744	66	2,401
Adjustment on transfer of HBOS	1,320	1,867	74	3,261
Exchange and other adjustments	31	12	2	45
Gains (losses) recognised in the income statement	199	(56)	(46)	97
Gains recognised in other comprehensive income	–	271	–	271
Purchases	921	664	–	1,585
Sales	(550)	(560)	–	(1,110)
Transfers into the level 3 portfolio	62	–	780	842
Transfers out of the level 3 portfolio	(738)	(296)	(66)	(1,100)
At 31 December 2010	2,836	2,646	810	6,292
Exchange and other adjustments	**(8)**	**(45)**	**(2)**	**(55)**
Gains recognised in the income statement	**139**	**78**	**670**	**887**
Losses recognised in other comprehensive income	**–**	**(148)**	**–**	**(148)**
Purchases	**518**	**343**	**–**	**861**
Sales	**(747)**	**(580)**	**–**	**(1,327)**
Transfers into the level 3 portfolio	**331**	**146**	**47**	**524**
Transfers out of the level 3 portfolio	**(128)**	**(384)**	**(48)**	**(560)**
At 31 December 2011	**2,941**	**2,056**	**1,477**	**6,474**
Gains recognised in the income statement relating to those assets held at 31 December 2011	**203**	**31**	**176**	**410**
Losses recognised in other comprehensive income relating to those assets held at 31 December 2011	**–**	**(132)**	**–**	**(132)**
Gains (losses) recognised in the income statement relating to those assets held at 31 December 2010	149	(81)	(47)	21
Gains recognised in other comprehensive income relating to those assets held at 31 December 2010	–	269	–	269

The table below analyses movements in the level 3 financial liabilities portfolio:

	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities £m
At 1 January 2010	–	38	38
Adjustment for transfer of HBOS	196	–	196
Exchange and other adjustments	14	–	14
Additions	–	16	16
Redemptions	(210)	–	(210)
Transfers into the level 3 portfolio	203	–	203
At 31 December 2010	203	54	257
Losses recognised in the income statement	**585**	**5**	**590**
Redemptions	**–**	**(10)**	**(10)**
Transfers into the level 3 portfolio	**18**	**–**	**18**
Tranfers out of the level 3 portfolio	**(65)**	**–**	**(65)**
At 31 December 2011	**741**	**49**	**790**
Losses recognised in the income statement relating to those liabilities held at 31 December 2011	**(93)**	**(5)**	**(98)**
Gains (losses) recognised in the income statement relating to those liabilities held at 31 December 2010	–	–	–

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

Included within the gains (losses) recognised in the income statement are gains of £410 million (2010: £21 million) related to financial instruments that are held in the level 3 portfolio at the year end. These amounts are included in other operating income.

54 Financial instruments (continued)

Included within the gains (losses) recognised in other comprehensive income are losses of £132 million (2010: gains of £269 million) related to financial instruments that are held in the level 3 portfolio at the year end.

The Bank	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Derivative assets £m	Total financial assets £m
At 1 January 2010	90	462	66	618
Gains (losses) recognised in the income statement	6	–	(9)	(3)
Gains recognised in other comprehensive income	–	7	–	7
Purchases	9	–	–	9
Sales	(12)	(58)	–	(70)
Transfers into the level 3 portfolio	–	–	553	553
Transfers out of the level 3 portfolio	–	(40)	(66)	(106)
At 31 December 2010	93	371	544	1,008
Exchange and other adjustments	**(2)**	**(1)**	**–**	**(3)**
Gains recognised in the income statement	**8**	**–**	**630**	**638**
Losses recognised in other comprehensive income	**–**	**(4)**	**–**	**(4)**
Purchases	**–**	**2**	**–**	**2**
Sales	**(99)**	**51**	**–**	**(48)**
Transfers into the level 3 portfolio	**–**	**105**	**–**	**105**
Transfers out of the level 3 portfolio	**–**	**(371)**	**(49)**	**(420)**
At 31 December 2011	**–**	**153**	**1,125**	**1,278**
Gains recognised in the income statement relating to those assets held at 31 December 2011	**–**	**–**	**101**	**101**
Losses recognised in other comprehensive income relating to those assets held at 31 December 2011	**–**	**(4)**	**–**	**(4)**
Gains (losses) recognised in the income statement relating to those assets held at 31 December 2010	6	–	(9)	(3)
Gains recognised in other comprehensive income relating to those assets held at 31 December 2010	–	7	–	7

The table below analyses movements in the level 3 financial liabilities portfolio:

	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities £m
At 1 January 2010	–	38	38
Additions	–	4	4
Transfers into the level 3 portfolio	169	–	169
At 31 December 2010	169	42	211
Losses recognised in the income statement	**582**	**–**	**582**
Redemptions	**–**	**(10)**	**(10)**
Transfers into the level 3 portfolio	**–**	**–**	**–**
Tranfers out of the level 3 portfolio	**(45)**	**–**	**(45)**
At 31 December 2011	**706**	**32**	**738**
Losses recognised in the income statement relating to those liabilities held at 31 December 2011	**(93)**	**–**	**(93)**
Gains (losses) recognised in the income statement relating to those liabilities held at 31 December 2010	–	–	–

Included within the gains (losses) recognised in the income statement are gains of £101 million (2010: losses of £3 million) related to financial instruments that are held in the level 3 portfolio at the year end. These amounts are included in other operating income.

Including within the gains (losses) recognised in other comprehensive income are losses of £4 million (2010: gains of £7 million) related to financial instruments that are held in the level 3 portfolio at the year end.

54 Financial instruments (continued)

Included within the gains (losses) recognised in other comprehensive income are losses of £132 million (2010: gains of £269 million) related to financial instruments that are held in the level 3 portfolio at the year end.

			At 31 December 2011			At 31 December 2010		
				Effect of reasonably possible alternative assumptions			Effect of reasonably possible alternative assumptions	
	Valuation basis/technique	Main assumptions	**Carrying value £m**	**Favourable changes £m**	**Unfavourable changes £m**	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss:								
Asset-backed securities	Lead manager or broker quote/consensus pricing from market data provider.	Use of single pricing source	**203**	**1**	**(1)**	283	8	(8)
Equity and venture capital investments	Various valuation techniques	Earnings, net asset value and earnings multiples, forecast cash flows	**1,823**	**56**	**(59)**	2,072	135	(111)
Unlisted equities and property partnerships in the life funds	Third party valuations	n/a	**915**	**n/a**	**n/a**	481	n/a	n/a
			2,941			2,836		
Available-for-sale financial assets:								
Asset-backed securities	Lead manager or broker quote/consensus pricing from market data provider	Use of single pricing source	**257**	**1**	**(1)**	579	34	(34)
Equity and venture capital investments	Various valuation techniques	Earnings, net asset value, underlying asset values, property prices, forecast cash flows	**1,799**	**183**	**(88)**	2,067	141	(91)
			2,056			2,646		
Derivative financial assets	Industry standard model/consensus pricing from market data provider	Prepayment rates, probability of default, loss given default and yield curves	**1,477**	**88**	**(20)**	810	96	(27)
Financial assets			**6,474**			6,292		
Derivative financial liabilities	Industry standard model/consensus pricing from market data provider	Prepayment rates, probability of default, loss given default and yield curves	**741**	**–**	**–**	203	–	–
Financial guarantees			**49**	**–**	**–**	54	–	–
Financial liabilities			**790**			257		

54 Financial instruments (continued)

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

Sensitivity of level 3 valuations
Asset-backed securities
Reasonably possible alternative valuations have been calculated for asset-backed securities by using alternative pricing sources and calculating an absolute difference. The pricing difference is defined as the absolute difference between the actual price used and the closest, alternative price available.

Derivative financial instruments
(i) In respect of the embedded equity conversion feature of the enhanced capital notes, the sensitivity was based on the absolute difference between the actual price of the enhanced capital note and the closest, alternative broker quote available plus the impact of applying a 10 bps increase/decrease in the market yield used to derive a market price for similar bonds without the conversion feature. The effect of interdependency of the assumptions is not material to the effect of applying reasonably possible alternative assumptions to the valuations of derivative financial instruments.

(ii) In respect of credit default swaps written on level 3 negative basis asset-backed securities, reasonably possible alternative valuations have been calculated by flexing the spread between the underlying asset and the credit default swap, or adjusting market yields, by a reasonable amount. The sensitivity is determined by applying a 60 bps increase/decrease in the spread between the asset and the credit default swap.

Venture capital and equity investments
Third party valuers have been used to determine the value of unlisted equities and property partnerships included in the Group's life insurance funds. The valuation techniques used for unlisted equities and venture capital investments vary depending on the nature of the investment, as described in the valuation methodology section above. Reasonably possible alternative valuations for these investments have been calculated by reference to the relevant approach taken as appropriate to the business sector and investment circumstances and as such the following inputs have been considered:

- for valuations derived from earnings multiples, consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple;
- the discount rates used in discounted cash flow valuations; and
- in line with international Private Equity and Venture Capital Guidelines, the values of underlying investments in fund investments portfolios.

Derivative valuation adjustments
Derivative financial instruments which are carried in the balance sheet at fair value are adjusted where appropriate to reflect credit risk, market liquidity and other risks.

(i) Uncollateralised derivative valuation adjustments, excluding monoline counterparties
The following table summarises the movement on this valuation adjustment account during 2011.

Uncollateralised derivative valuation adjustments

	2011 £m	2010 £m
At 1 January	**570**	662
Income statement charge	**718**	20
Transfers	**(62)**	(112)
At 31 December	**1,226**	570

Represented by:

	2011 £m	2010 £m
Credit Valuation Adjustment (CVA)	**1,425**	671
Debit Valuation Adjustment (DVA)	**(493)**	(298)
Funding Valuation Adjustment	**294**	197
	1,226	570

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

A CVA is taken where the Group has a positive future uncollateralised exposure (asset). A DVA is taken where the Group has a negative future uncollateralised exposure (liability). These adjustments reflect interest rates and expectations of counterparty creditworthiness and the Group's own credit spread respectively.

The CVA is sensitive to:

– the current size of the mark-to-market position on the uncollateralised asset;
– expectations of future market volatility of the underlying asset; and
– expectations of counterparty creditworthiness.

In circumstances where exposures to a counterparty become impaired, any associated derivative valuation adjustment is transferred and assessed for specific loss alongside other non-derivative assets and liabilities that the counterparty may have with the Group.

Market Credit Default Swap (CDS) spreads are used to develop the probability of default for quoted counterparties. For unquoted counterparties, internal credit ratings and market sector CDS curves and recovery rates are used. The Loss Given Default (LGD) is based on market recovery rates and internal credit assessments.

54 Financial instruments (continued)

The combination of a one per cent deterioration in the credit rating of derivative counterparties and a ten per cent increase in LGD increases the CVA by £140 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (in total contributing £84 million of the overall CVA balance at 31 December 2011).

The DVA is sensitive to:

– the current size of the mark-to-market position on the uncollateralised liability;
– expectations of future market volatility of the underlying liability; and
– the Group's own CDS spread.

A one per cent rise in the CDS spread would lead to an increase in the DVA of £125 million to £618 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A one per cent rise in interest rates would lead to a £369 million fall in the overall valuation adjustment to £563 million. The CVA model used by the Group does not assume any correlation between the level of interest rates and default rates.

The Group has also recognised a Funding Valuation Adjustment to adjust for the net cost of funding certain uncollateralised derivative positions where the Group considers that this cost is included in market pricing. This adjustment is calculated on the expected future exposure discounted at a suitable cost of funds. A ten basis points increase in the cost of funds will increase the funding valuation adjustment by approximately £11 million.

(ii) Uncollateralised derivative valuation adjustments – monoline counterparties
The Group has no significant derivative exposures remaining against monoline counterparties as shown in note 55(F).

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

At 31 December 2011, the Group's derivative trading business held mid to bid-offer valuation adjustments of £85 million (31 December 2010: £66 million).

(iv) Libor/Overnight Index Swap (OIS) basis
The Group's derivative trading business applies £74 million (31 December 2010: £70 million) of valuation adjustments against the changing market approach to valuing derivatives that are subject to daily collateral margin, where standard market practice is to pay interest on an Overnight Index Swap (OIS) basis rather than a Libor rate.

No credit valuation adjustment is taken on collateralised swaps.

Own credit adjustments
The carrying amount of issued notes that are designated under the IAS 39 fair value option is adjusted to reflect the effect of changes in own credit spreads. The resulting gain or loss is recognised in the income statement.

At 31 December 2011, the own credit adjustment arising from the fair valuation of £5,339 million (31 December 2010: £6,665 million) of the Group's debt securities in issue designated at fair value through profit or loss resulted in a gain of £194 million (2010: no gain or loss).

(4) Transferred financial assets that are not derecognised
Repurchase and securities lending transactions
The Group enters into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets concerned. The carrying value of financial assets transferred under such arrangements, that did not qualify for derecognition, and their associated liabilities are as follows:

	2011		2010	
	Carrying value of transferred assets £m	**Carrying value of associated liabilities £m**	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
Trading and other financial assets at fair value through profit or loss	**523**	**513**	824	828
Debt securities classified as loans and receivables	**5,045**	**4,326**	1,386	1,043
Available-for-sale financial assets	**2,435**	**2,258**	1,467	1,378
Total	**8,003**	**7,097**	3,677	3,249

In all cases the transferee has the right to sell or repledge the assets concerned.

Securitisations and covered bonds
Details about the Group's securitisation and covered bond programmes, which may also result in financial assets not being derecognised in full, are provided in note 20.

55 Financial risk management

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

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

(1) Credit risk

The Group's credit risk exposure arises in respect of the instruments below and predominantly in the United Kingdom, the European Union, Australia and the United States. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems as inputs. The Group uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers, such as asset sales and credit derivative based transactions.

A. Maximum credit exposure

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

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Loans and receivables:				
Loans and advances to banks, net[1]	**32,606**	30,272	**167,896**	152,596
Loans and advances to customers, net[1]	**584,237**	611,089	**249,113**	251,173
Debt securities, net[1]	**12,470**	25,735	**633**	1,479
Deposit amounts available for offset, net[2]	**(4,174)**	(8,105)	**(4,171)**	(4,183)
	625,139	658,991	**413,471**	401,065
Available-for-sale financial assets (excluding equity shares)	**36,015**	40,700	**31,304**	24,878
Held-to-maturity investments	**8,098**	7,905	**8,098**	7,905
Trading and other financial assets at fair value through profit or loss (excluding equity shares)[3]:				
Loans and advances	**11,121**	12,545	**69**	325
Debt securities, treasury and other bills	**52,363**	53,463	**4,580**	4,233
	63,484	66,008	**4,649**	4,558
Derivative assets:				
Derivative assets, before netting	**64,842**	49,600	**37,517**	21,322
Amounts available for offset under master netting arrangements[2]	**(46,618)**	(31,740)	**(23,733)**	(12,901)
	18,224	17,860	**13,784**	8,421
Assets arising from reinsurance contracts held	**2,534**	2,146	**–**	–
Financial guarantees	**10,831**	22,975	**9,489**	11,143
Irrevocable loan commitments and other credit-related contingencies[4]	**57,329**	67,809	**39,987**	42,764
Maximum credit risk exposure	**821,654**	884,394	**520,782**	500,734
Maximum credit risk exposure before offset items	**872,446**	924,239	**548,686**	517,818

[1] Amounts shown net of related impairment allowances.

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

[3] Includes assets within the Group's unit-linked funds for which credit risk is borne by the policyholders and assets within the Group's With Profits funds for which credit risk is largely borne by the policyholders. Consequently the Group has no significant exposure to credit risk for such assets which back related contract liabilities.

[4] See note 53 – Contingent liabilities and commitments for further information.

55 Financial risk management (continued)

B. Credit quality of assets

Loans and receivables

The disclosures in the table above are produced under the combined businesses approach used for the Lloyds Banking Group's segmental reporting. The Group believes that, for reporting periods immediately following a significant business combination such as the transfer of HBOS in 2010, this combined businesses basis, which includes the allowance for loan losses in place at the date of the acquisition of HBOS by the Lloyds Banking Group on a gross basis, more fairly reflects the underlying provisioning status of the loans. The remaining acquisition-related fair value adjustments in respect of this lending are therefore identified separately in this table.

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

Loans and advances – The Group

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2011						
Neither past due nor impaired	**32,494**	**330,727**	**41,448**	**146,655**	**518,830**	**11,121**
Past due but not impaired	**15**	**12,742**	**1,093**	**2,509**	**16,344**	**–**
Impaired – no provision required	**6**	**1,364**	**1,604**	**3,544**	**6,512**	**–**
– provision held	**105**	**6,701**	**2,940**	**44,116**	**53,757**	**–**
Gross	**32,620**	**351,534**	**47,085**	**196,824**	**595,443**	**11,121**
Allowance for impairment losses	**(14)**	**(2,731)**	**(1,848)**	**(23,139)**	**(27,718)**	**–**
Fair value adjustments	**–**				**(2,087)**	**–**
Net	**32,606**				**565,638**	**11,121**
Due from fellow Lloyds Banking Group undertakings	**–**				**18,599**	**–**
Total loans and advances	**32,606**				**584,237**	**11,121**

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2010						
Neither past due nor impaired	30,259	339,509	45,058	159,274	543,841	12,545
Past due but not impaired	–	13,215	1,289	3,427	17,931	–
Impaired – no provision required	–	2,189	433	5,313	7,935	–
– provision held	20	5,591	5,149	45,931	56,671	–
Gross	30,279	360,504	51,929	213,945	626,378	12,545
Allowance for impairment losses	(20)	(2,073)	(2,587)	(24,975)	(29,635)	–
Fair value adjustments	13				(4,146)	–
Net	30,272				592,597	12,545
Due from fellow Lloyds Banking Group undertakings	–				18,492	–
Total loans and advances	30,272				611,089	12,545

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

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2h. All impaired loans which exceed certain thresholds, principally within the Group's wholesale and corporate businesses, are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security. Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £48,142 million (2010: £51,608 million).

55 Financial risk management (continued)

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

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2011						
Good quality	**32,141**	**323,060**	**29,123**	**71,907**		**11,065**
Satisfactory quality	**171**	**5,432**	**9,747**	**42,311**		**45**
Lower quality	**9**	**970**	**1,127**	**24,676**		**11**
Below standard, but not impaired	**173**	**1,265**	**1,451**	**7,761**		**–**
Total loans and advances which are neither past due nor impaired	**32,494**	**330,727**	**41,448**	**146,655**	**518,830**	**11,121**
31 December 2010						
Good quality	29,835	332,614	30,076	57,552		12,220
Satisfactory quality	265	5,259	11,084	42,906		163
Lower quality	16	834	1,170	45,750		83
Below standard, but not impaired	143	802	2,728	13,066		79
Total loans and advances which are neither past due nor impaired	30,259	339,509	45,058	159,274	543,841	12,545

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models.

Loans and advances which are past due but not impaired – The Group

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2011						
0-30 days	**1**	**5,989**	**868**	**1,163**	**8,020**	**–**
30-60 days	**9**	**2,618**	**195**	**481**	**3,294**	**–**
60-90 days	**4**	**1,833**	**25**	**260**	**2,118**	**–**
90-180 days	**–**	**2,302**	**4**	**159**	**2,465**	**–**
Over 180 days	**1**	**–**	**1**	**446**	**447**	**–**
Total loans and advances which are past due but not impaired	**15**	**12,742**	**1,093**	**2,509**	**16,344**	**–**
31 December 2010						
0-30 days	–	6,498	1,004	1,331	8,833	–
30-60 days	–	2,674	246	498	3,418	–
60-90 days	–	1,811	29	394	2,234	–
90-180 days	–	2,223	10	337	2,570	–
Over 180 days	–	9	–	867	876	–
Total loans and advances which are past due but not impaired	–	13,215	1,289	3,427	17,931	–

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

55 Financial risk management (continued)

Loans and advances – The Bank

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2011						
Neither past due nor impaired	**5,222**	**90,625**	**22,014**	**64,284**	**176,923**	**69**
Past due but not impaired	**15**	**2,159**	**443**	**647**	**3,249**	**–**
Impaired – no provision required	**–**	**390**	**888**	**485**	**1,763**	**–**
– provision held	**105**	**850**	**1,470**	**5,364**	**7,684**	**–**
Gross	**5,342**	**94,024**	**24,815**	**70,780**	**189,619**	**69**
Allowance for impairment losses (note 23)	**(14)**	**(240)**	**(731)**	**(2,498)**	**(3,469)**	**–**
Net	**5,328**	**93,784**	**24,084**	**68,282**	**186,150**	**69**
Due from fellow Lloyds Banking Group undertakings	**162,568**				**62,963**	**–**
Total loans and advances	**167,896**				**249,113**	**69**

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2010						
Neither past due nor impaired	7,053	94,960	22,257	59,523	176,740	325
Past due but not impaired	–	2,263	562	340	3,165	–
Impaired – no provision required	–	620	343	848	1,811	–
– provision held	20	1,095	2,447	5,027	8,569	–
Gross	7,073	98,938	25,609	65,738	190,285	325
Allowance for impairment losses (note 23)	(20)	(248)	(1,016)	(1,887)	(3,151)	–
Net	7,053	98,690	24,593	63,851	187,134	325
Due from fellow Lloyds Banking Group undertakings	145,543				64,039	–
Total loans and advances	152,596				251,173	325

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

Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £5,853 million (2010: £5,932 million).

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

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2011						
Good quality	**5,101**	**90,217**	**15,962**	**38,006**		**18**
Satisfactory quality	**105**	**381**	**4,754**	**21,151**		**41**
Lower quality	**9**	**19**	**706**	**4,410**		**10**
Below standard, but not impaired	**7**	**8**	**592**	**717**		**–**
Total loans and advances which are neither past due nor impaired	**5,222**	**90,625**	**22,014**	**64,284**	**176,923**	**69**
31 December 2010						
Good quality	6,778	93,963	13,947	33,103		–
Satisfactory quality	265	997	6,358	19,748		163
Lower quality	7	–	628	5,606		83
Below standard, but not impaired	3	–	1,324	1,066		79
Total loans and advances which are neither past due nor impaired	7,053	94,960	22,257	59,523	176,740	325

55 Financial risk management (continued)

Loans and advances which are past due but not impaired – The Bank

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2011						
0-30 days	**1**	**1,131**	**338**	**156**	**1,625**	**–**
30-60 days	**9**	**429**	**99**	**87**	**615**	**–**
60-90 days	**4**	**260**	**6**	**108**	**374**	**–**
90-180 days	**–**	**339**	**–**	**46**	**385**	**–**
Over 180 days	**1**	**–**	**–**	**250**	**250**	**–**
Total loans and advances which are past due but not impaired	**15**	**2,159**	**443**	**647**	**3,249**	**–**
31 December 2010						
0-30 days	–	1,136	420	152	1,708	–
30-60 days	–	442	132	18	592	–
60-90 days	–	292	4	41	337	–
90-180 days	–	387	6	22	415	–
Over 180 days	–	6	–	107	113	–
Total loans and advances which are past due but not impaired	–	2,263	562	340	3,165	–

A financial asset is ‘past due’ if a counterparty has failed to make a payment when contractually due.

55 Financial risk management (continued)

Debt securities classified as loans and receivables

An analysis by credit rating of debt securities classified as loans and receivables is provided below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
The Group							
At 31 December 2011							
Asset-backed securities:							
Mortgage-backed securities	**2,008**	**2,326**	**1,423**	**1,024**	**369**	**29**	**7,179**
Other asset-backed securities	**3,585**	**430**	**374**	**237**	**403**	**1**	**5,030**
	5,593	**2,756**	**1,797**	**1,261**	**772**	**30**	**12,209**
Corporate and other debt securities	**150**	**–**	**67**	**–**	**–**	**320**	**537**
Total debt securities classified as loans and receivables	**5,743**	**2,756**	**1,864**	**1,261**	**772**	**350**	**12,746**
At 31 December 2010							
Asset-backed securities:							
Mortgage-backed securities	6,524	2,856	1,057	840	222	151	11,650
Other asset-backed securities	7,535	2,514	1,377	475	823	103	12,827
	14,059	5,370	2,434	1,315	1,045	254	24,477
Corporate and other debt securities	163	164	459	106	166	758	1,816
Total debt securities classified as loans and receivables	14,222	5,534	2,893	1,421	1,211	1,012	26,293
The Bank							
At 31 December 2011							
Asset-backed securities:							
Mortgage-backed securities	**100**	**54**	**51**	**114**	**62**	**133**	**514**
Other asset-backed securities	**–**	**–**	**11**	**–**	**31**	**1**	**43**
	100	**54**	**62**	**114**	**93**	**134**	**557**
Corporate and other debt securities	**150**	**–**	**42**	**–**	**–**	**–**	**192**
Total debt securities classified as loans and receivables	**250**	**54**	**104**	**114**	**93**	**134**	**749**
At 31 December 2010							
Asset-backed securities:							
Mortgage-backed securities	165	54	41	41	134	218	653
Other asset-backed securities	1	35	10	7	46	–	99
	166	89	51	48	180	218	752
Corporate and other debt securities	163	164	264	91	112	123	917
Total debt securities classified as loans and receivables	329	253	315	139	292	341	1,669

55 Financial risk management (continued)

Available-for-sale financial assets (excluding equity shares)
An analysis of available-for-sale financial assets is included in note 24. The credit quality of available-for-sale financial assets (excluding equity shares) is set out below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
The Group							
At 31 December 2011							
Debt securities							
Government securities	**19,051**	**6,179**	**–**	**–**	**–**	**6**	**25,236**
Other public sector securities	**–**	**–**	**–**	**–**	**–**	**27**	**27**
Bank and building society certificates of deposit	**81**	**177**	**71**	**37**	**–**	**–**	**366**
Asset-backed securities:							
Mortgage-backed securities	**626**	**491**	**398**	**185**	**103**	**–**	**1,803**
Other asset-backed securities	**399**	**299**	**224**	**34**	**90**	**18**	**1,064**
	1,025	**790**	**622**	**219**	**193**	**18**	**2,867**
Corporate and other debt securities	**1,609**	**856**	**2,351**	**341**	**–**	**88**	**5,245**
Total debt securities	**21,766**	**8,002**	**3,044**	**597**	**193**	**139**	**33,741**
Treasury bills and other bills	**1,717**	**–**	**10**	**–**	**–**	**–**	**1,727**
Total held as available-for-sale financial assets	**23,483**	**8,002**	**3,054**	**597**	**193**	**139**	**35,468**
Due from fellow group undertakings:							
Corporate and other debt securities							**546**
Total held as available-for-sale financial assets							**36,014**
At 31 December 2010							
Debt securities							
Government securities	12,462	78	–	–	–	12	12,552
Other public sector securities	–	–	–	–	–	29	29
Bank and building society certificates of deposit	–	225	162	20	–	–	407
Asset-backed securities:							
Mortgage-backed securities	2,809	673	601	202	8	–	4,293
Other asset-backed securities	3,625	781	395	115	79	224	5,219
	6,434	1,454	996	317	87	224	9,512
Corporate and other debt securities	1,135	4,824	5,150	913	42	68	12,132
Total debt securities	20,031	6,581	6,308	1,250	129	333	34,632
Treasury bills and other bills	4,439	–	1,629	–	–	–	6,068
Total held as available-for-sale financial assets	24,470	6,581	7,937	1,250	129	333	40,700

55 Financial risk management (continued)

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
The Bank							
At 31 December 2011							
Debt securities							
Government securities	**18,962**	**6,105**	**–**	**–**	**–**	**–**	**25,067**
Other public sector securities	**–**	**–**	**–**	**–**	**–**	**27**	**27**
Bank and building society certificates of deposit	**81**	**178**	**38**	**32**	**–**	**–**	**329**
Asset-backed securities:							
Mortgage-backed securities	**63**	**267**	**95**	**72**	**–**	**–**	**497**
Other asset-backed securities	**132**	**139**	**21**	**7**	**6**	**–**	**305**
	195	**406**	**116**	**79**	**6**	**–**	**802**
Corporate and other debt securities	**–**	**–**	**–**	**–**	**–**	**22**	**22**
Total debt securities	**19,238**	**6,689**	**154**	**111**	**6**	**49**	**26,247**
Treasury bills and other bills	**21**	**–**	**8**	**–**	**–**	**–**	**29**
	19,259	**6,689**	**162**	**111**	**6**	**49**	**26,276**
Due from fellow Group undertakings:							
Corporate and other debt securities							**5,028**
Total held as available-for-sale financial assets							**31,304**
At 31 December 2010							
Debt securities							
Government securities	12,398	–	–	–	–	7	12,405
Other public sector securities	–	–	–	–	–	29	29
Bank and building society certificates of deposit	–	225	32	14	–	1	272
Asset-backed securities:							
Mortgage-backed securities	571	208	173	12	7	–	971
Other asset-backed securities	815	177	159	36	58	9	1,254
	1,386	385	332	48	65	9	2,225
Corporate and other debt securities	–	526	369	59	–	23	977
Total debt securities	13,784	1,136	733	121	65	69	15,908
Treasury bills and other bills	3,235	–	689	–	–	–	3,924
	17,019	1,136	1,422	121	65	69	19,832
Due from fellow Group undertakings:							
Corporate and other debt securities							5,046
Total held as available-for-sale financial assets							24,878

55 Financial risk management (continued)

Held-to-maturity investments
An analysis of the credit quality of the Group's held-to-maturity investments is provided below:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
The Group							
At 31 December 2011							
Government securities	**6,319**	**1,779**	**–**	**–**	**–**	**–**	**8,098**
At 31 December 2010							
Government securities	7,905	–	–	–	–	–	7,905
The Bank							
At 31 December 2011							
Government securities	**6,319**	**1,779**	**–**	**–**	**–**	**–**	**8,098**
At 31 December 2010							
Government securities	7,905	–	–	–	–	–	7,905

55 Financial risk management (continued)

Debt securities, treasury and other bills held at fair value through profit or loss
An analysis of trading and other financial assets at fair value through profit or loss is included in note 16. The credit quality of debt securities, treasury and other bills held at fair value through profit or loss is set out below.

The Group	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
At 31 December 2011							
Trading assets							
Government securities	**1,994**	**6**	**–**	**–**	**–**	**–**	**2,000**
Bank and building society certificates of deposit	**1**	**1,147**	**1,573**	**142**	**–**	**–**	**2,863**
Asset-backed securities:							
Mortgage-backed securities	**64**	**33**	**1**	**–**	**1**	**–**	**99**
Other asset-backed securities	**19**	**151**	**52**	**–**	**–**	**–**	**222**
	83	**184**	**53**	**–**	**1**	**–**	**321**
Corporate and other debt securities	**315**	**141**	**312**	**490**	**151**	**179**	**1,588**
Total debt securities held as trading assets	**2,393**	**1,478**	**1,938**	**632**	**152**	**179**	**6,772**
Treasury bills and other bills	**224**	**75**	**–**	**–**	**–**	**–**	**299**
Total held as trading assets	**2,617**	**1,553**	**1,938**	**632**	**152**	**179**	**7,071**
Other assets held at fair value through profit or loss							
Government securities	**17,667**	**1,027**	**950**	**642**	**644**	**437**	**21,367**
Other public sector securities	**908**	**170**	**35**	**59**	**11**	**–**	**1,183**
Bank and building society certificates of deposit	**–**	**330**	**55**	**–**	**–**	**–**	**385**
Asset-backed securities:							
Mortgage-backed securities	**194**	**45**	**255**	**116**	**–**	**2**	**612**
Other asset-backed securities	**321**	**198**	**794**	**382**	**53**	**16**	**1,764**
	515	**243**	**1,049**	**498**	**53**	**18**	**2,376**
Corporate and other debt securities	**3,114**	**2,111**	**6,197**	**5,195**	**1,199**	**2,165**	**19,981**
Total other assets held at fair value through profit or loss	**22,204**	**3,881**	**8,286**	**6,394**	**1,907**	**2,620**	**45,292**
Total held at fair value through profit or loss	**24,821**	**5,434**	**10,224**	**7,026**	**2,059**	**2,799**	**52,363**
At 31 December 2010							
Trading assets							
Government securities	651	888	–	84	–	–	1,623
Bank and building society certificates of deposit	–	3,086	506	100	–	–	3,692
Asset-backed securities – other	191	633	196	–	–	–	1,020
Corporate and other debt securities	1,205	1,209	1,839	183	13	470	4,919
Total debt securities held as trading assets	2,047	5,816	2,541	367	13	470	11,254
Treasury bills and other bills	219	8	–	–	–	–	227
Total held as trading assets	2,266	5,824	2,541	367	13	470	11,481
Other assets held at fair value through profit or loss							
Government securities	20,509	1,113	408	33	6	148	22,217
Other public sector securities	778	62	68	2	–	9	919
Bank and building society certificates of deposit	52	107	447	–	–	–	606
Asset-backed securities:							
Mortgage-backed securities	259	68	48	23	–	24	422
Other asset-backed securities	298	372	458	384	70	10	1,592
	557	440	506	407	70	34	2,014
Corporate and other debt securities	3,870	1,619	4,397	3,269	1,275	1,760	16,190
Total other assets held at fair value through profit or loss	25,766	3,341	5,826	3,711	1,351	1,951	41,946
	28,032	9,165	8,367	4,078	1,364	2,421	53,427
Due from fellow Group undertakings:							
Corporate and other debt securities – trading							36
Total held at fair value through profit or loss							53,463

Credit risk in respect of trading and other financial assets at fair value through profit or loss here within the Group's unit-linked funds is borne by the policyholders and credit risk in respect of With Profits funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back those contract liabilities.

55 Financial risk management (continued)

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
The Bank							
At 31 December 2011							
Trading assets							
Government securities	**1,002**	**6**	**–**	**–**	**–**	**–**	**1,008**
Bank and building society certificates of deposit	**–**	**85**	**1,252**	**142**	**–**	**–**	**1,479**
Corporate and other debt securities	**103**	**141**	**312**	**390**	**151**	**179**	**1,276**
Asset backed securities:							
Mortgage backed securities	**64**	**34**	**1**	**–**	**–**	**–**	**99**
Other asset backed securities	**19**	**–**	**–**	**–**	**–**	**–**	**19**
	83	**34**	**1**	**–**	**–**	**–**	**118**
Total debt securities	**1,188**	**266**	**1,565**	**532**	**151**	**179**	**3,881**
Treasury bills and other bills	**–**	**75**	**–**	**–**	**–**	**–**	**75**
Total held as trading assets	**1,188**	**341**	**1,565**	**532**	**151**	**179**	**3,956**
Other assets held at fair value through profit or loss							
Corporate and other debt securities	**–**	**–**	**–**	**–**	**–**	**496**	**496**
Total other assets held at fair value through profit or loss	**–**	**–**	**–**	**–**	**–**	**496**	**496**
	1,188	**341**	**1,565**	**532**	**151**	**675**	**4,452**
Due from fellow Group undertakings – corporate and other							**128**
Total held at fair value through profit or loss							**4,580**
At 31 December 2010							
Trading assets							
Government securities	133	3	–	84	–	–	220
Asset-backed securities – other	–	–	47	–	–	–	47
Corporate and other debt securities	79	1,009	1,428	165	13	473	3,167
Total held as trading assets	212	1,012	1,475	249	13	473	3,434
Other assets held at fair value through profit or loss							
Government securities	13	–	–	–	–	–	13
Asset-backed securities – other	–	–	–	47	–	–	47
Corporate and other debt securities	–	–	41	185	349	72	647
Total other assets held at fair value through profit or loss	13	–	41	232	349	72	707
	225	1,012	1,516	481	362	545	4,141
Due from fellow Group undertakings – corporate and other debt securities – trading							92
Total held at fair value through profit or loss							4,233

55 Financial risk management (continued)

Derivative financial instruments
An analysis of derivative assets is given in note 17. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's maximum credit risk relating to derivative assets of £18,224 million for the Group and £13,784 million for the Bank (2010: £17,860 million for the Group and £8,421 million for the Bank), cash collateral of £5,269 million for the Group and £2,970 million for the Bank (2010: £1,429 million for the Group and £75 million for the Bank) was held and a further £7,875 million for the Group and £5,176 million for the Bank was due from OECD banks (2010: £8,385 million for the Group and £5,083 million for the Bank).

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
The Group							
At 31 December 2011							
Trading	**313**	**25,268**	**14,474**	**6,612**	**3,588**	**1,738**	**51,993**
Hedging	**35**	**8,717**	**3,237**	**786**	**9**	**65**	**12,849**
Total derivative financial instruments	**348**	**33,985**	**17,711**	**7,398**	**3,597**	**1,803**	**64,842**
At 31 December 2010							
Trading	157	18,161	13,486	1,006	86	9,298	42,194
Hedging	57	1,992	4,368	46	–	943	7,406
Total derivative financial instruments	214	20,153	17,854	1,052	86	10,241	49,600
The Bank							
At 31 December 2011							
Trading	**183**	**15,901**	**6,266**	**3,935**	**1,820**	**65**	**28,170**
Hedging	**–**	**1,936**	**481**	**164**	**7**	**8**	**2,596**
	183	**17,837**	**6,747**	**4,099**	**1,827**	**73**	**30,766**
Due from fellow Group undertakings							**6,751**
Total derivative financial instruments							**37,517**
At 31 December 2010							
Trading	129	12,035	1,475	550	86	4,443	18,718
Hedging	–	7	30	–	–	919	956
	129	12,042	1,505	550	86	5,362	19,674
Due from fellow Group undertakings							1,648
Total derivative financial instruments							21,322

Assets arising from reinsurance contracts held
Of the assets arising from reinsurance contracts held at 31 December 2011 of £2,535 million (2010: £2,146 million), £842 million (2010: £671 million) were due from insurers with a credit rating of AA or above.

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

55 Financial risk management (continued)

C. Collateral held as security for financial assets
The Group holds collateral against loans and receivables and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for trading and other financial assets at fair value through profit or loss and for derivative assets is also shown below.

Loans and receivables
The Group holds collateral in respect of loans and advances to banks and customers as set out below. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

Loans and advances to banks
The Group may require collateral before entering into a credit commitment with another bank, depending on the type of financial product and the counterparty involved, and netting arrangements are obtained whenever possible and to the extent that such agreements are legally enforceable. Collateral is held as part of reverse repurchase or securities borrowing transactions.

There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £508 million for the Group and £38,543 million for the Bank (2010: £4,185 million for the Group and £61,099 million for the Bank), against which the Group held collateral with a fair value of £511 million for the Group and £38,860 million for the Bank (2010: £3,909 million for the Group and £61,926 million for the Bank), all of which the Group is able to repledge. Included in these amounts in 2010 are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £4 million for the Group and £nil for the Bank.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Loans and advances to customers
The Group holds collateral against loans and advances to customers in the form of mortgages over residential and commercial real estate, charges over business assets such as premises, inventory and accounts receivable, charges over financial instruments such as debt securities and equities, and guarantees received from third parties.

Retail lending
Mortgages
An analysis by loan-to-value ratio of the Group's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations.

The Group

	Neither past due nor impaired £m	**Past due but not impaired £m**	**Impaired £m**	**Gross £m**
31 December 2011				
Less than 70 per cent	**137,224**	**3,203**	**1,420**	**141,847**
70 per cent to 80 per cent	**60,236**	**1,894**	**843**	**62,973**
80 per cent to 90 per cent	**53,113**	**2,250**	**1,103**	**56,466**
90 per cent to 100 per cent	**40,236**	**2,182**	**1,196**	**43,614**
Greater than 100 per cent	**39,918**	**3,213**	**3,503**	**46,634**
Total	**330,727**	**12,742**	**8,065**	**351,534**

	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
31 December 2010				
Less than 70 per cent	140,267	3,191	1,376	144,834
70 per cent to 80 per cent	57,979	1,869	787	60,635
80 per cent to 90 per cent	53,732	2,381	1,138	57,251
90 per cent to 100 per cent	43,263	2,413	1,359	47,035
Greater than 100 per cent	44,268	3,361	3,120	50,749
Total	339,509	13,215	7,780	360,504

55 Financial risk management (continued)

The Bank

	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
31 December 2011				
Less than 70 per cent	**44,954**	**699**	**292**	**45,945**
70 per cent to 80 per cent	**15,864**	**315**	**142**	**16,321**
80 per cent to 90 per cent	**12,567**	**347**	**186**	**13,100**
90 per cent to 100 per cent	**9,536**	**360**	**203**	**10,099**
Greater than 100 per cent	**7,704**	**438**	**417**	**8,559**
Total	**90,625**	**2,159**	**1,240**	**94,024**

	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
31 December 2010				
Less than 70 per cent	47,956	719	407	49,082
70 per cent to 80 per cent	16,156	343	184	16,683
80 per cent to 90 per cent	13,070	380	252	13,702
90 per cent to 100 per cent	10,178	381	314	10,873
Greater than 100 per cent	7,600	440	558	8,598
Total	94,960	2,263	1,715	98,938

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

The majority of non-mortgage retail lending is unsecured. At 31 December 2011, total non-mortgage lending amounted to £47,085 million (2010: £51,929 million), against which the Group held an impairment allowance of £1,848 million (2010: £2,587 million). Gross impaired non-mortgage retail lending amounted to £4,544 million (2010: £5,582 million). The fair value of the collateral held in respect of this lending was £43 million (2010: £40 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation and the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Unimpaired non-mortgage retail lending amounted to £43,659 million (2010: £46,347 million). Lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination and are monitored throughout the credit lifecycle in accordance with business unit credit policy.

The Group credit risk disclosures for unimpaired non-mortgage retail lending report assets gross of collateral and therefore disclose the maximum loss exposure. The Group believes that this approach is appropriate. The value of collateral is reassessed if there is observable evidence of distress of the borrower. Unimpaired non-mortgage retail lending, including any associated collateral, is managed on a customer-by-customer basis rather than a portfolio basis. No aggregated collateral information for the entire unimpaired non-mortgage retail lending portfolio is provided to key management personnel.

Wholesale lending
Reverse repurchase transactions
There were reverse repurchase agreements which are accounted for as collateralised loans with a carrying value of £16,835 million for the Group and £2,585 million for the Bank (2010: £3,096 million for the Group and £517 million for the Bank), against which the Group held collateral with a fair value of £16,936 million for the Group and £2,682 million for the Bank (2010: £2,987 million for the Group and £510 million for the Bank), all of which the Group is able to repledge. Included in these amounts are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £34 million for the Group and £nil for the Bank (2010: £42 million for the Group and £nil for the Bank). These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Impaired lending
The value of collateral is re-evaluated and its legal soundness re-assessed if there is observable evidence of distress of the borrower; this evaluation is used to determine potential loss allowances and management's strategy to try to either repair the business or recover the debt.

55 Financial risk management (continued)

At 31 December 2011, total wholesale lending amounted to £196,824 million (2010: £213,945 million), against which the Group held an impairment allowance of £23,139 million (2010: £24,975 million). Gross impaired wholesale lending amounted to £47,660 million (2010: £51,244 million). The fair value of the collateral held in respect of impaired wholesale lending which is secured was £13,977 million (2010: £14,520 million) for the Group. In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured wholesale lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Impaired secured wholesale lending and associated collateral relates to lending to property companies and to customers in the financial, business and other services; transport, distribution and hotels; and construction industries.

Unimpaired lending
Wholesale unimpaired lending amounted to £149,164 million (2010: £162,701 million). Wholesale lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination. The types of collateral taken and the frequency with which collateral is required at origination is dependent upon the size and structure of the borrower. For exposures to corporate customers and other large institutions, the Group will often require the collateral to include a first charge over land and buildings owned and occupied by the business, a mortgagee debenture over the company's undertaking and one or more of its assets, and keyman insurance. The Group maintains policies setting out acceptable collateral, maximum loan-to-value ratios and other criteria to be considered when reviewing a loan application. The decision as to whether or not collateral is required will be based upon the nature of the transaction and the credit worthiness of the customer. Other than for project finance, object finance and income producing real estate where charges over the subject assets are a basic requirement, the provision of collateral will not determine the outcome of a credit application. The fundamental business proposition must evidence the ability of the business to generate funds from normal business sources to repay debt.

The extent to which collateral values are actively managed will depend on the credit quality and other circumstances of the obligor. Although lending decisions are predominantly based on expected cash flows, any collateral provided may impact the pricing and other terms of a loan or facility granted; this will have a financial impact on the amount of net interest income recognised and on internal loss-given-default estimates that contribute to the determination of asset quality.

For unimpaired wholesale lending which is secured, the Group reports assets gross of collateral and therefore discloses the maximum loss exposure. The Group believes that this approach is appropriate as collateral values at origination and during a period of good performance may not be representative of the value of collateral if the obligor enters a distressed state.

Unimpaired secured wholesale lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for impaired lending, this will not always involve assessing it on a fair value basis. No aggregated collateral information for the entire unimpaired secured wholesale lending portfolio is provided to key management personnel.

Trading and other financial assets at fair value through profit or loss (excluding equity shares)

In respect of trading and other financial assets at fair value through profit or loss, the fair value of collateral accepted under reverse repurchase transactions which are accounted for as collateralised loans that the Group is permitted by contract or custom to sell or repledge was £15,765 million for the Group and £nil for the Bank (2010: £14,299 million for the Group and £nil for the Bank). Of this, £3,740 million for the Group and £nil for the Bank (2010: £3,161 million for the Group and £nil for the Bank) was sold or repledged.

In addition, securities held as collateral in the form of stock borrowed amounted to £10,438 million for the Group and £78,222 million for the Bank (2010 £72,224 million for the Group and £49,408 million for the Bank). Of this amount, £5,308 million for the Group and £47,989 million for the Bank (2010: £52,393 million for the Group and £39,086 million for the Bank) had been resold or repledged as collateral for the Group's own transactions.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Derivative assets, after offsetting of amounts under master netting arrangements
The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £18,224 million for the Group and £13,784 million for the Bank (2010: £17,860 million for the Group and £8,421 million for the Bank), cash collateral of £5,269 million for the Group and £2,970 million for the Bank (2010: £1,429 million for the Group and £75 million for the Bank) was held.

These transactions were generally conducted under terms that are usual andcustomary for standard secured lending activities.

Irrevocable loan commitments and other credit-related contingencies
The Group pledges assets primarily for repurchase agreements and securities lending transactions where are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

At 31 December 2011, there were irrevocable loan commitments and other credit-related contingencies of £57,329 million for the Group and £39,987 million for the Bank (2010: £67,809 million for the Group and £42,764 million for the Bank). Collateral is held as security, in the event that lending is drawn down, on £13,279 million for the Group and £9,071 million for the Bank (2010: £13,011 million for the Group and £6,663 million for the Bank) of these balances.

Lending decisions in respect of irrevocable loan commitments are based on the obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. For wholesale commitments, it is the Group's practice to request collateral whose value is commensurate with the nature of the commitments. For retail mortgage commitments, the majority are for mortgages with a loan-to-value ratio of less than 100 per cent. Aggregated collateral information covering the entire balance of irrevocable loan commitments over which security will be taken is not provided to key management personnel.

55 Financial risk management (continued)

D. Collateral pledged as security

Repo and stock lending transactions

The Group pledges assets primarily for repurchase agreements and securities lending transactions which are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge was £39,679 million for the Group and £29,015 million for the Bank (2010: £53,781 million for the Group and £42,744 million for the Bank). In addition, the following financial assets on the balance sheet have been pledged as collateral as part of securities lending transactions:

Assets pledged

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Trading and other financial assets at fair value through profit or loss	**3,102**	4,289	**20**	–
Loans and advances to customers	**37,926**	102,151	**–**	24,850
Debt securities classified as loans and receivables	**398**	4,324	**351**	–
Available-for-sale financial assets	**1,618**	13,375	**10,374**	13,132
	43,044	124,139	**10,745**	37,982

In addition to the assets detailed above, the Group also holds assets that are encumbered through the Group's asset-backed conduits and its securitisation and covered bond programmes. Further details of these assets are provided in notes 20 and 21.

E. Collateral repossessed

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Residential property	**968**	1,046	**158**	211
Other	**13**	32	**–**	–
	981	1,078	**158**	211

In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

F. Credit market exposures

The Group's credit market exposures primarily relate to asset-backed securities exposures held in Wholesale division. An analysis of the carrying value of these exposures, which are classified as loans and receivables (note 22), available-for-sale financial assets (note 24) or trading and other financial assets at fair value through profit or loss (note 16) depending on the nature of the investment, is set out below.

	Loans and receivables £m	**Available-for-sale £m**	**Trading £m**	**Net exposure as at 31 December 2011 £m**	Net exposure as at 31 December 2010 £m
Mortgage-backed securities:					
US residential	**4,063**	**–**	**–**	**4,063**	4,242
Non-US residential	**1,837**	**1,189**	**99**	**3,125**	7,898
Commercial	**1,175**	**613**	**–**	**1,788**	3,516
	7,075	**1,802**	**99**	**8,976**	15,656
Collateralised debt obligations					
Collateralised loan obligations	**915**	**195**	**52**	**1,162**	4,686
Others	**264**	**–**	**–**	**264**	494
	1,179	**195**	**52**	**1,426**	5,180
Federal family education loan programme	**3,380**	**146**	**–**	**3,526**	7,777
Personal sector	**145**	**366**	**–**	**511**	3,967
Other asset-backed securities	**314**	**322**	**20**	**656**	1,035
Total uncovered asset-backed securities	**12,093**	**2,831**	**171**	**15,095**	33,615
Negative basis[1]	**–**	**36**	**150**	**186**	1,109
Total Wholesale asset-backed securities	**12,093**	**2,867**	**321**	**15,281**	34,724
Direct	**9,067**	**1,317**	**321**	**10,705**	22,296
Conduits (note 21)	**3,026**	**1,550**	**–**	**4,576**	12,428
Total Wholesale asset-backed securities	**12,093**	**2,867**	**321**	**15,281**	34,724

[1] Negative basis means bonds held with separate matching credit default swap protection.

55 Financial risk management (continued)

Exposure to monolines

At 31 December 2011, the Group had no direct exposure to sub-investment grade monolines on credit default swap (CDS) contracts. Its exposure to investment grade monolines through CDS contracts was £14 million (gross exposure: £168 million) and through wrapped loans and receivables was £178 million (gross exposure: £274 million).

The exposure to monolines arising from negative basis trades is calculated as the mark-to-market of the CDS protection purchased from the monoline insurer after credit valuation adustments. The exposure to monolines on wrapped loans and receivables and bonds is the internal assessment of amounts that will be recovered on interest and principal shortfalls,

In addition, the Group has £1,550 million (31 December 2010: £1,985 million) of monoline wrapped bonds and £274 million (31 December 2010: £425 million) of monoline wrapped liquidity commitments on which the Group currently places no reliance on the guarantor.

An analysis of the Wholesale division's asset-backed securities portfolio by credit rating is provided below.

	Net Exposure £m	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Below B £m
Asset class								
Mortgage-backed securities								
US residential mortgage-backed securities:								
Prime	777	175	393	97	100	12	–	–
Alt-A	3,286	1,144	781	633	651	77	–	–
Sub-prime	–	–	–	–	–	–	–	–
	4,063	1,319	1,174	730	751	89	–	–
Non-US residential mortgage-backed securities	3,125	1,318	935	399	309	164	–	–
Commercial mortgage-backed securities	1,788	273	604	648	199	64	–	–
	8,976	2,910	2,713	1,777	1,259	317	–	–
Collateralised debt obligations								
Collateralised loan obligations	1,162	274	455	331	7	50	16	29
Others	264	1	1	–	111	151	–	–
	1,426	275	456	331	118	201	16	29
Personal sector	511	273	165	15	58	–	–	–
Federal family education loan programme	3,526	3,419	107	–	–	–	–	–
Other asset-backed securities	656	61	52	197	94	252	–	–
Total uncovered asset-backed securities	15,095	6,938	3,493	2,320	1,529	770	16	29
Negative basis[1]								
Monolines	150	–	150	–	–	–	–	–
Banks	36	36	–	–	–	–	–	–
	186	36	150	–	–	–	–	–
Total as at 31 December 2011	15,281	6,974	3,643	2,320	1,529	770	16	29
Total as at 31 December 2010	34,724	20,805	7,310	3,713	1,764	763	147	222

[1] The external credit rating is based on the bond ignoring the benefit of the CDS.

55 Financial risk management (continued)

(2) Market risk

Interest rate risk

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There are a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio.

At 31 December 2011 the aggregate notional principal of interest rate swaps designated as fair value hedges was £110,943 million (2010: £75,831 million) for the Group and £53,808 million (2010: £30,777 million) for the Bank with a net fair value asset of £5,483 million (2010: asset of £3,166 million) for the Group and £1,687 million (2010: asset of £338 million) for the Bank (note 17). The gains recognised by the Group on the hedging instruments were £1,982 million (2010: £280 million). The Group's losses on the hedged items attributable to the hedged risk were £1,999 million (2010: £452 million).

In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next six years and the hedge accounting adjustments will be reported in the income statement as the cash flows arise. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2011 was £207,343 million (2010: £112,507 million) for the Group and £1,075 million (2010: £1,597 million) for the Bank with a net fair value liability of £358 million (2010: £843 million) for the Group and £18 million (2010: £60 million) for the Bank (note 17). In 2011, ineffectiveness recognised in the income statement that arises from cash flow hedges was a loss of £13 million (2010: gain of £160 million).

Currency risk

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the central market risk function.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the new investment in certain foreign operations using currency borrowings and cross currency derivatives. At 31 December 2011 the aggregate notional principal of these currency borrowings was £2,245 million (2010: £5,135 million); the aggregate notional principle of the cross currency derivatives was £49 million (2010: cross currency swaps £86 million) with a fair value liability of £1 million (2010: asset of £2 million) and they were designated on an after-tax basis as hedges of net investments in foreign operations. In 2011, an ineffectiveness gain of £23 million before tax and £17 million after tax (2010: ineffectiveness loss of £28 million before tax and £20 million after tax) was recognised in the income statement arising from net investment hedges.

55 Financial risk management (continued)

The Group's main overseas operations are in the Americas, Asia, Australasia and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Functional currency of Group operations				
Euro:				
Gross exposure	**585**	2,468	**(44)**	(4)
Net investment hedge	**(848)**	(3,270)	**–**	–
	(263)	(802)	**(44)**	(4)
US dollar:				
Gross exposure	**341**	47	**49**	53
Net investment hedge	**(122)**	(145)	**–**	–
	219	(98)	**49**	53
Swiss franc:				
Gross exposure	**15**	53	**(4)**	31
Net investment hedge	**–**	–	**–**	–
	15	53	**(4)**	31
Australian dollar:				
Gross exposure	**1,232**	1,567	**(5)**	(4)
Net investment hedge	**(1,226)**	(1,634)	**–**	–
	6	(67)	**(5)**	(4)
Japanese yen:				
Gross exposure	**20**	17	**20**	17
Net investment hedge	**–**	–	–	–
	20	17	**20**	17
Other non-sterling	**170**	155	**356**	343
Total structural foreign currency exposures, after net investment hedges	**167**	(742)	**372**	436

55 Financial risk management (continued)

(3) Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the FSA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The tables below analyse financial instrument liabilities of the Group and the Bank, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
The Group						
At 31 December 2011						
Deposits from banks	**19,402**	**5,863**	**5,517**	**10,469**	**1,292**	**42,543**
Customer deposits	**326,125**	**16,534**	**33,670**	**44,920**	**11,948**	**433,197**
Trading and other financial liabilities at fair value through profit or loss	**10,284**	**2,336**	**3,516**	**6,491**	**4,127**	**26,754**
Debt securities in issue	**34,839**	**27,207**	**26,164**	**74,503**	**39,440**	**202,153**
Liabilities arising from non-participating investment contracts	**27,429**	**–**	**–**	**–**	**22,207**	**49,636**
Subordinated liabilities	**191**	**258**	**3,022**	**15,551**	**30,002**	**49,024**
Total non-derivative financial liabilities	**418,270**	**52,198**	**71,889**	**151,934**	**109,016**	**803,307**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**37,751**	**11,363**	**9,211**	**32,169**	**28,942**	**119,436**
Gross settled derivatives – inflows	**(3,924)**	**(9,205)**	**(7,635)**	**(22,189)**	**(21,363)**	**(64,316)**
Gross settled derivatives – net flows	**33,827**	**2,158**	**1,576**	**9,980**	**7,579**	**55,120**
Net settled derivative liabilities	**25,061**	**388**	**1,356**	**4,208**	**968**	**31,981**
Total derivative financial liabilities	**58,888**	**2,546**	**2,932**	**14,188**	**8,547**	**87,101**
At 31 December 2010						
Deposits from banks	24,938	11,804	4,301	10,557	920	52,520
Customer deposits	307,622	15,136	33,132	43,516	24,415	423,821
Trading and other financial liabilities at fair value through profit or loss	11,293	2,218	5,125	5,544	3,633	27,813
Debt securities in issue	31,225	41,143	52,549	91,166	35,202	251,285
Liabilities arising from non-participating investment contracts	12,944	91	265	1,743	36,320	51,363
Subordinated liabilities	178	1,005	4,087	12,746	21,381	39,397
Total non-derivative financial liabilities	388,200	71,397	99,459	165,272	121,871	846,199
Derivative financial liabilities:						
Gross settled derivatives – outflows	41,594	34,665	19,089	103,600	52,449	251,397
Gross settled derivatives – inflows	(17,094)	(34,823)	(19,211)	(103,563)	(51,815)	(226,506)
Gross settled derivatives – net flows	24,500	(158)	(122)	37	634	24,891
Net settled derivative liabilities	3,001	2,204	6,479	13,537	5,524	30,745
Total derivative financial liabilities	27,501	2,046	6,357	13,574	6,158	55,636

In addition, the Group has a maximum credit risk exposure of £10,831 million (2010: £22,975 million) in respect of financial guarantees.

The majority of the Group's non-participating investment contract liabilities are unit-linked. These unit-linked products are invested in accordance with unit fund mandates. Clauses are included in policyholder contracts to permit the deferral of sales, where necessary, so that linked assets can be realised without being a forced seller.

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £158 million (2010: £146 million) per annum for the Group and £113 million (2010: £43 million) for the Bank which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

55 Financial risk management (continued)

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
The Bank						
At 31 December 2011						
Deposits from banks	**63,234**	**14,674**	**13,715**	**58,187**	**6,783**	**156,593**
Customer deposits	**171,251**	**13,072**	**22,093**	**17,928**	**8,134**	**232,478**
Trading and other financial liabilities at fair value through profit or loss	**784**	**449**	**776**	**6,491**	**3,601**	**12,101**
Debt securities in issue	**22,344**	**20,606**	**16,036**	**38,974**	**28,696**	**126,656**
Subordinated liabilities	**163**	**247**	**1,136**	**9,099**	**23,473**	**34,118**
Total non-derivative financial liabilities	**257,776**	**49,048**	**53,756**	**130,679**	**70,687**	**561,946**
Gross settled derivatives – outflows	**33,864**	**1,446**	**1,293**	**9,928**	**6,150**	**52,681**
Gross settled derivatives – inflows	**(508)**	**(95)**	**(127)**	**(1,333)**	**(853)**	**(2,916)**
Gross settled derivatives – net flows	**33,356**	**1,351**	**1,166**	**8,595**	**5,297**	**49,765**
Net settled derivative liabilities	**70**	**188**	**54**	**190**	**76**	**578**
Total derivative financial liabilities	**33,426**	**1,539**	**1,220**	**8,785**	**5,373**	**50,343**

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2010						
Deposits from banks	88,314	23,566	16,300	14,115	6,328	148,623
Customer deposits	148,295	13,449	20,939	19,566	18,550	220,799
Trading and other financial liabilities at fair value through profit or loss	428	132	2,773	5,442	3,632	12,407
Debt securities in issue	9,028	25,513	33,242	35,664	19,371	122,818
Subordinated liabilities	157	889	590	6,199	15,622	23,457
Total non-derivative financial liabilities	246,222	63,549	73,844	80,986	63,503	528,104
Gross settled derivatives – outflows	28,795	21,366	10,414	54,276	22,675	137,526
Gross settled derivatives – inflows	(4,520)	(21,336)	(10,502)	(54,117)	(21,787)	(112,262)
Gross settled derivatives – net flows	24,275	30	(88)	159	888	25,264
Net settled derivative liabilities	955	596	595	1,568	2,057	5,771
Total derivative financial liabilities	25,230	626	507	1,727	2,945	31,035

Liabilities of the Group arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	1-2 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2011	**748**	**1,724**	**5,257**	**18,132**	**53,140**	**79,001**
At 31 December 2010	2,481	1,459	5,072	18,431	53,306	80,749

55 Financial risk management (continued)

The following tables set out the amounts and residual maturities of off balance sheet contingent liabilities and commitments.

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
The Group					
31 December 2011					
Acceptances and endorsements	**81**	**–**	**–**	**–**	**81**
Other contingent liabilities	**1,514**	**1,092**	**426**	**757**	**3,789**
Total contingent liabilities	**1,595**	**1,092**	**426**	**757**	**3,870**
Lending commitments	**71,216**	**13,999**	**17,380**	**2,287**	**104,882**
Other commitments	**701**	**–**	**–**	**–**	**701**
Total commitments	**71,917**	**13,999**	**17,380**	**2,287**	**105,583**
Total contingents and commitments	**73,512**	**15,091**	**17,806**	**3,044**	**109,453**
31 December 2010					
Acceptances and endorsements	48	–	–	–	48
Other contingent liabilities	1,897	1,248	269	717	4,131
Total contingent liabilities	1,945	1,248	269	717	4,179
Lending commitments	76,456	22,537	13,424	3,739	116,156
Other commitments	1,038	61	–	43	1,142
Total commitments	77,494	22,598	13,424	3,782	117,298
Total contingents and commitments	79,439	23,846	13,693	4,499	121,477

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
The Bank					
31 December 2011					
Acceptances and endorsements	**80**	**–**	**–**	**–**	**80**
Other contingent liabilities	**1,187**	**1,025**	**237**	**627**	**3,076**
Total contingent liabilities	**1,267**	**1,025**	**237**	**627**	**3,156**
Lending commitments	**42,574**	**19,316**	**12,505**	**1,504**	**75,899**
Other commitments	**693**	**–**	**–**	**–**	**693**
Total commitments	**43,267**	**19,316**	**12,505**	**1,504**	**76,592**
Total contingents and commitments	**44,534**	**20,341**	**12,742**	**2,131**	**79,748**
31 December 2010					
Acceptances and endorsements	50	–	–	–	50
Other contingent liabilities	1,425	1,199	171	639	3,434
Total contingent liabilities	1,475	1,199	171	639	3,484
Lending commitments	54,152	18,898	6,490	1,695	81,235
Other commitments	1,910	51	–	3	1,964
Total commitments	56,062	18,949	6,490	1,698	83,199
Total contingents and commitments	57,537	20,148	6,661	2,337	86,683

(4) Insurance risk

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

The Group's appetite for solvency and earnings in insurance entities is reviewed and approved annually by the Board. Insurance risks are measured using a variety of techniques including stress and scenario testing; and where appropriate, stochastic modelling. Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitorting relevant experiences against expectations, as well as evaluating the effectiveness of controls put in place to manage insurance risk.

56 Capital

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the Lloyds Banking Group Senior Asset and Liability Committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight.

The Group's regulatory capital is divided into tiers 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 the European Community Banking Consolidation Directive as implemented in the UK by the FSA's General Prudential Sourcebook (GENPRU), is core tier 1 capital plus tier 1 capital securities less 50 per cent of material holdings in financial companies. Tier 2 capital, defined by GENPRU, comprises qualifying subordinated debt and some additional provisions and reserves after deducting 50 per cent of the excess of expected loss over accounting provisions, and certain securitisation positions and material holdings in financial companies. 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 the Group, this means that the net assets of its life assurance and general insurance businesses and the non-financial entities that are held by our private equity (including venture capital) businesses, are excluded from its total regulatory capital.

The Group's capital resources are summarised as follows:

	2011 £m	2010 £m
Tier 1 capital	**50,220**	49,375
Tier 2 capital	**25,214**	21,073
	75,434	70,448
Supervisory deductions	**(23,159)**	(13,112)
Total capital	**52,275**	57,336

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 minimum total capital required under pillar 1 of the Basel II framework is the Capital Resources Requirement (CRR) calculated as 8 per cent of risk weighted assets. In addition to the minimum requirements for total capital, the FSA has made statements to explain it also operates a framework of targets and expected buffers for core tier 1 and tier 1 capital.

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 Individual Capital Guidance (ICG) for each UK bank calibrated by reference to the CRR. A key input into the FSA's ICG setting process is each bank's Internal Capital Adequacy Assessment Process. The Group has been given an ICG by the FSA. The FSA has made it clear, however, that ICG remains a confidential matter between each bank and the FSA.

The Group maintains its own buffer to ensure that the regulatory minimum requirements and regulatory targets and buffers are met at all times.

During the course of the year there have been a number of significant regulatory reform developments:

- 'CRD III' came into force on 31 December 2011 resulting in increased risk weighted assets for market risk.
- The European Commission published a draft of the new Capital Requirements Directive and Regulation ('CRDIV') which will implement within the EU the so called 'Basel III' reforms for an enhanced global capital accord developed by the Basel Committee on Banking Supervision.
- In December the Government announced that it would implement the key recommendations of the UK's Independent Commission on Banking covering the ring-fencing of certain banking activities, 'bail-in' of senior unsecured debt, higher loss absorption capability and depositor preference.
- The Group is aware that there is currently a review of the endorsed ratings that may be used in IRB models and the Group is working on the assumption that no material changes to our modelling approaches will result from the review.

Many of the details of the way these reforms will be integrated within the UK are still to be finalised. In the meantime the Group continues to monitor their development very closely and to analyse their potential impact whilst ensuring that the Group continues to have a strong loss absorption capacity exceeding regulatory requirements as currently formulated.

The impact of the reforms will gradually phase in as they are subject to a long transition period through to 2022. That allows time for the Group to further strengthen its capital position as necessary through business performance and mitigating actions.

During the year, the individual entities within the Group and the Group complied with all of the externally imposed capital requirements to which they are subject.

57 Cash flow statements

a Change in operating assets

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Change in loans and receivables	**39,254**	40,624	**(14,065)**	26,753
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**6,190**	(8,092)	**(16,271)**	(5,342)
Change in other operating assets	**(1,392)**	(660)	**73**	(408)
Change in operating assets	**44,052**	31,872	**(30,263)**	21,003

57 Cash flow statements (continued)

b Change in operating liabilities

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Change in deposits from banks	**(10,480)**	(32,355)	**36,329**	(42,164)
Change in customer deposits	**8,111**	(12,620)	**3,732**	22,617
Change in debt securities in issue	**(35,812)**	(6,155)	**(4,880)**	4,233
Change in derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	**14,251**	183	**14,407**	8,334
Change in investment contract liabilities	**793**	8,160	**–**	–
Change in other operating liabilities	**(5)**	(2,774)	**552**	376
Change in operating liabilities	**(23,142)**	(45,561)	**50,140**	(6,604)

c Non-cash and other items

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Depreciation and amortisation	**2,175**	2,432	**394**	373
Impairment of tangible fixed assets	**65**	202	**–**	–
Revaluation of investment properties	**107**	(434)	**–**	–
Allowance for loan losses	**8,069**	10,771	**2,462**	2,371
Write-off of allowance for loan losses	**(7,405)**	(6,909)	**(2,125)**	(2,911)
Impairment of available-for-sale financial assets	**80**	106	**–**	21
Change in insurance contract liabilities	**(2,091)**	4,029	**–**	–
Customer goodwill payments provision	**–**	500	**–**	–
Payment protection insurance provision	**3,200**	–	**1,867**	–
German insurance business litigation provision	**175**	–	**–**	–
Other provision movements	**(294)**	49	**(213)**	36
Net charge (credit) in respect of defined benefit schemes	**199**	(455)	**63**	(205)
Impact of consolidation and deconsolidation of OEICs[1]	**(6,094)**	(878)	**–**	–
Unwind of discount on impairment allowances	**(226)**	(403)	**(103)**	(93)
Foreign exchange element on balance sheet[2]	**161**	(834)	**172**	839
Liability management (gains) losses within other income[3]	**(599)**	(352)	**–**	7
Interest expense on subordinated liabilities	**1,608**	3,217	**688**	936
(Profit) loss on disposal of businesses	**21**	314	**–**	–
Other non-cash items	**679**	(205)	**343**	(258)
Total non-cash items	**(170)**	11,150	**3,548**	1,116
Contributions to defined benefit schemes	**(838)**	(653)	**(361)**	(187)
Payments in respect of customer goodwill payments provision	**(497)**	–	**–**	–
Payments in respect of payment protection insurance provision	**(1,045)**	–	**(640)**	–
Other	**6**	1	**–**	–
Total other items	**(2,374)**	(652)	**(1,001)**	(187)
Non-cash and other items	**(2,544)**	10,498	**2,547**	929

[1] These OEICs (Open-ended investment companies) are mutual funds which are consolidated if the Group manages the funds and also has a majority beneficial interest. The population of OEICs to be consolidated varies at each reporting date as external investors acquire and divest holdings in the various funds. The consolidation of these funds is effected by the inclusion of the fund investments and a matching liability to the unit holders; and changes in funds consolidated represent a non-cash movement on the balance sheet.

[2] When considering the movement on each line of the balance sheet, the impact of foreign exchange rate movements is removed in order to show the underlying cash impact.

[3] A number of capital transactions entered into by the Group in 2011 and 2010 involved the exchange of existing securities for new issues and as a result there was no related cash flow.

57 Cash flow statements (continued)

d Analysis of cash and cash equivalents as shown in the balance sheet

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Cash and balances with central banks	**60,722**	38,115	**57,500**	35,585
Less: mandatory reserve deposits[1]	**(1,070)**	(1,089)	**(528)**	(732)
	59,652	37,026	**56,972**	34,853
Loans and advances to banks	**32,606**	30,272	**167,896**	152,596
Less: amounts with a maturity of three months or more and balances due from fellow Lloyds Banking Group undertakings	**(6,369)**	(4,998)	**(165,919)**	(147,060)
	26,237	25,274	**1,977**	5,536
Total cash and cash equivalents	**85,889**	62,300	**58,949**	40,389

[1] Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents of the Group at 31 December 2011 is £21,601 million (2010: £14,694 million) held within the Group's life funds, which is not immediately available for use in the business.

e Acquisition of group undertakings and businesses

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Net assets transferred in respect of HBOS:				
Cash and balances at central banks	**–**	2,905	**–**	–
Derivatives, trading and other financial assets at fair value through profit or loss	**–**	132,038	**–**	–
Loans and receivables	**–**	435,875	**–**	–
Available-for-sale financial assets	**–**	21,459	**–**	–
Deposits from banks	**–**	(29,600)	**–**	–
Customer deposits	**–**	(232,091)	**–**	–
Derivatives, trading and other financial liabilities at fair value through profit or loss	**–**	(47,710)	**–**	–
Debt securities in issue	**–**	(112,815)	**–**	–
Insurance contract liabilities	**–**	(70,617)	**–**	–
Subordinated liabilities	**–**	(14,653)	**–**	–
Amounts with other Lloyds Banking Group undertakings (net)	**–**	(63,419)	**–**	–
Non-controlling interests	**–**	(1,271)	**–**	–
Other assets (net)	**–**	7,641	**–**	–
Total net assets transferred	**–**	27,742	**–**	–
Satisfied by:				
Issue of shares	**–**	(21,394)	**–**	–
Merger reserve arising on transfer	**–**	(6,348)	**–**	–
Cash and cash equivalents acquired	**–**	9,084	**–**	–
Net cash inflow arising from transfer of HBOS	**–**	9,084	**–**	–
Additional capital injections to subsidiaries	**–**	–	**(159)**	(219)
Acquisition of and additional investment in associates and joint ventures	**(10)**	(65)	**–**	–
Net cash (outflow) inflow arising from acquisitions in the year	**(10)**	9,019	**(159)**	(219)
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**(3)**	(8)	**–**	–
Net cash inflow	**(13)**	9,011	**(159)**	(219)

For more details on the assets and liabilities relating to the transfer of HBOS see note 31.

f Disposal of group undertakings and businesses

	The Group		The Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Net assets and liabilities disposed of	**319**	742	**4**	18
Loss on sale of businesses	**(21)**	(314)	**–**	–
Cash and cash equivalents disposed of	**–**	–	**–**	–
Net cash inflow from disposals	**298**	428	**4**	18

58 Future accounting developments

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2011 and have not been applied in preparing these financial statements. Save as disclosed, the full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
Amendments to IFRS 7 Financial Instruments: Disclosures – 'Disclosures-Offsetting Financial Assets and Financial Liabilities'	Requires an entity to disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's balance sheet.	Annual and interim periods beginning on or after 1 January 2013.
IFRS 9 *Financial Instruments*[1]	Replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the classification, measurement and derecognition of financial assets and liabilities. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The available-for-sale financial asset and held-to-maturity investment categories in IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39.	Annual periods beginning on or after 1 January 2015.
IFRS 10 *Consolidated Financial Statements*	Supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* and establishes principles for the preparation of consolidated financial statements when an entity controls one or more entities.	Annual periods beginning on or after 1 January 2013.
IFRS 12 *Disclosure of Interests in Other Entities*	Requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.	Annual periods beginning on or after 1 January 2013.
IFRS 13 *Fair Value Measurement*	The standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements.	Annual periods beginning on or after 1 January 2013.
IAS 19 *Employee Benefits*	Prescribes the accounting and disclosure by employers for employee benefits. Actuarial gains and losses (remeasurements) in respect of defined benefit pension schemes can no longer be deferred using the corridor approach and must be recognised immediately in other comprehensive income. At 31 December 2011, unrecognised actuarial losses were £539 million. The income statement charge for 2011 would have been approximately £200 million higher under the revised standard.	Annual periods beginning on or after 1 January 2013.
Amendments to IAS 32 *Financial Instruments: Presentation – 'Offsetting Financial Assets and Financial Liabilities'*	Inserts application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard. Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement.	Annual periods beginning on or after 1 January 2014.

[1]IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39.

At the date of this report, these pronouncements are awaiting EU endorsement.

59 Approval of the financial statements and other information

The financial statements were approved by the directors of Lloyds TSB Bank plc on 23 February 2012.

Lloyds TSB Bank plc and its subsidiaries form a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

Lloyds TSB Bank plc's ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland. Copies of the consolidated annual report and accounts of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

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