Bank of Scotland plc

Report and Accounts
2019

Member of Lloyds Banking Group

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Strategic report

Principal activities

Bank of Scotland plc (the Bank) and its subsidiaries (together, the Group) provide a wide range of banking and financial services 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 other products to commercial, corporate and asset finance customers; and private banking.

Business review

In the year to 31 December 2019, the Group recorded a profit before tax of £1,278 million compared to £2,231 million recorded in the year to 31 December 2018.

Total income increased by £69 million, or 1 per cent, to £6,033 million in the year ended 31 December 2019 compared to £5,964 million in 2018 with a £255 million decrease in net interest income being more than offset by an increase of £324 million in other income.

Net interest income was £5,428 million in the year ended 31 December 2019, a decrease of £255 million, or 4 per cent compared to £5,683 million in 2018 with interest income on money market placements falling away in 2019 following the Lloyds Banking Group's ring-fencing activities in 2018 and an adverse impact from the Group's hedging arrangements in 2019 compared to 2018.

Other income was £324 million higher at £605 million in the year ended 31 December 2019 compared to £281 million in 2018. Net fee and commission income was £115 million higher at £320 million in the year ended 31 December 2019 compared to £205 million in 2018, largely reflecting reductions in interbank agency fee expense, card and package bank account fees and fees payable to fellow Lloyds Banking Group undertakings following the transfer out of certain activities as a consequence of the Lloyds Banking Group's ring-fencing programme. Net trading income, which is inherently volatile, was £228 million higher at £245 million in the year ended 31 December 2019 compared to £17 million in 2018. Other operating income was £19 million lower at £40 million in the year ended 31 December 2019 compared to £59 million in 2018.

Total operating expenses increased by £766 million to £4,305 million in the year ended 31 December 2019 compared with £3,539 million in the year ended 31 December 2018. There was a £782 million increase in regulatory provisions partly offset by a £16 million decrease in other operating expenses. The charge in respect of regulatory provisions was £1,217 million compared to £435 million in 2018 and comprised a charge of £963 million in respect of payment protection insurance and £254 million in respect of other conduct issues. The increase in payment protection insurance provision charges was largely due to the significant increase in PPI information requests leading up to the deadline for submission of claims on 29 August 2019. Other operating expenses were £16 million lower at £3,088 million in the year ended 31 December 2019 compared to £3,104 million in 2018.

Impairment losses increased by £256 million to £450 million in year ended to 31 December 2019 compared with £194 million in 2018, largely reflecting a single corporate exposure. Despite this underlying credit quality remains strong.

The tax expense for the year end 31 December 2019 was £604 million representing an effective tax rate of 47 per cent compared to £663 million in 2018 representing an effective tax rate of 30 per cent. This reflects the increase in non-deductible conduct provision charges.

Total assets were £37,026 million higher at £375,774 million at 31 December 2019 compared to £338,748 million at 31 December 2018. Loans and advances to customers decreased in the year by £4,009 million to £258,315 million, compared to £262,324 million at 31 December 2018, with the acquisition of Tesco Bank's UK prime residential mortgage portfolio and growth in consumer lending being more than offset by reductions in the closed mortgage book, the impact of the transfer of the Bank's Dutch loan book to Lloyds Banking Group's European ring-fenced bank and the optimisation of the corporate portfolio to address low risk-adjusted returning client relationships.

Amounts due from fellow Lloyds Banking Group undertakings were £38,602 million higher at £97,534 million compared to £58,932 million at 31 December 2018 as a result of reduced levels of settlement activity during 2019.

Customer deposits were £10,296 million lower at £151,845 million at 31 December 2019 compared to £162,141 million at 31 December 2018 as a result of reductions in the retail savings book as well as the impact of the transfer of the Bank's German deposit book to Lloyds Banking Group's European ring-fenced bank.

Amounts due to fellow Lloyds Banking Group undertakings were £49,849 million higher at £161,618 million at 31 December 2019 compared to £111,769 million at the previous year end, as a result of reduced levels of settlement activity during 2019.

Total equity increased by £1,470 million from £11,620 million at 31 December 2018 to £13,090 million at 31 December 2019 with total comprehensive income of £818 million and the issue of £1,200 million of other equity instruments more than offsetting dividends of £500 million and distributions on other equity instruments of £101 million.

The Group's common equity tier 1 capital ratio increased to 14.0 per cent (31 December 2018: 12.9 per cent), largely due to the retention of profits for the year. The tier 1 capital ratio increased to 18.7 per cent (31 December 2018: 15.8 per cent) due to the increase in common equity tier 1 capital and the issuance of a new AT1 capital instrument. The total capital ratio increased to 22.4 per cent (31 December 2018: 21.3 per cent) reflecting the increase in tier 1 capital, partially offset by the reduction in eligible provisions and a reduction in tier 2 capital instruments, largely reflecting the amortisation of dated instruments, a redemption and other adjustments.

Risk-weighted assets increased by £395 million, or 0.6 per cent, to £62,091 million at 31 December 2019 compared to £61,696 million at 31 December 2018, reflecting a net increase in credit risk, largely driven by the implementation of IFRS 16, the acquisition of the Tesco mortgage portfolio and mortgage model changes, offset in part by reductions in operational and market risks.

Post-tax return on average assets reduced from 0.5 per cent in 2018 to 0.2 per cent in 2019.

Future developments

Information about future developments is provided with the Principal risks and uncertainties section below.

Capital position at 31 December 2019

The Group's capital position as at 31 December 2019, applying CRD IV transitional rules and IFRS 9 transitional arrangements, is set out in the following section.

Table 1.1: Capital resources (audited)

Capital resources (transitional)	At 31 December 2019 £m	At 31 December 2018 £m
Common equity tier 1		
Shareholders' equity per balance sheet	**10,382**	10,112
Adjustment to retained earnings for foreseeable dividends	**–**	(500)
Cash flow hedging reserve	**41**	70
Other adjustments	**263**	291
	10,686	9,973
Less: deductions from common equity tier 1		
Goodwill and other intangible assets	**(461)**	(445)
Prudent valuation adjustment	**(92)**	(88)
Excess of expected losses over impairment provisions and value adjustments	**–**	(1)
Removal of defined benefit pension surplus	**(37)**	–
Deferred tax assets	**(1,390)**	(1,475)
Common equity tier 1 capital	**8,706**	7,964
Additional tier 1		
Additional tier 1 instruments	**2,913**	1,784
Total tier 1 capital	**11,619**	9,748
Tier 2		
Tier 2 instruments	**2,530**	3,205
Eligible provisions and other adjustments	**(242)**	165
Total tier 2 capital	**2,288**	3,370
Total capital resources	**13,907**	13,118
Risk-weighted assets (unaudited)	**62,091**	61,696
Common equity tier 1 capital ratio[1]	**14.0%**	12.9%
Tier 1 capital ratio[1]	**18.7%**	15.8%
Total capital ratio[1]	**22.4%**	21.3%

1 Reflecting the full impact of IFRS 9 at 31 December 2019, without the application of transitional arrangements, the Group's common equity tier 1 capital ratio would be 13.6 per cent, the tier 1 capital ratio would be 18.2 per cent and the total capital ratio would be 22.4 per cent.

Table 1.2: Risk-weighted assets (unaudited)

	At 31 December 2019 £m	At 31 December 2018 £m
Risk-weighted assets		
Foundation Internal Ratings Basel (IRB) Approach	**4,623**	5,363
Retail IRB Approach	**38,105**	35,754
Other IRB Approach	**1,774**	1,093
IRB Approach	**44,502**	42,210
Standardised Approach	**6,505**	6,816
Credit risk	**51,007**	49,026
Counterparty credit risk	**482**	599
Credit valuation adjustment risk	**78**	115
Operational risk	**9,611**	10,232
Market risk	**499**	1,235
Underlying risk-weighted assets	**61,677**	61,207
Threshold risk-weighted assets	**414**	489
Total risk-weighted assets	**62,091**	61,696

Section 172(1) Statement and Statement of Engagement with Employees and Other Stakeholders

In accordance with the Companies Act 2006 (the 'Act') (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), the Directors provide this statement on pages 5 to 9 describing how they have had regard to the matters set out in section 172(1) of the Act, when performing their duty to promote the success of the Bank, under section 172. Further details on key actions in this regard are also contained within the Corporate Governance Statement on pages 13 to 14 and the Directors' Report on pages 13 to 16.

In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018), this statement also provides details of how the Directors have engaged with and had regard to the interest of key stakeholders.

The Bank is a subsidiary of Lloyds Banking Group plc, and as such follows many of the processes and practices of this company, which are further referenced in this statement where relevant.

Engagement with all stakeholders

Engaging, consulting and acting on the needs of different stakeholders is critical for the development of a culture and strategy that achieves long-term sustainable success. The Board has a comprehensive stakeholder engagement programme and always aims to act in the best interest of the Bank and to be fair and balanced in its approach. The needs of different stakeholders are always considered as well as the consequences of any decision in the long-term and the importance of a reputation for high standards of business conduct. It may not always be possible to provide a positive outcome for all stakeholders and the Board frequently has to make difficult decisions based on competing priorities. However, comprehensive engagement enables informed decision making taking into account the consequences for different stakeholders.

To enable and ensure stakeholder considerations are at the heart of all corporate decision making, a wide range of papers relating to different stakeholder groups are presented and discussed regularly by the Board. In addition all papers submitted to the Board are required to consider the impact of proposals on key stakeholder groups. This section outlines the Board's key stakeholder groups, how the Board interacts with them and how they inform strategic decision making. It also provides examples of key strategic decisions made during the year and the Board engagement involved.

Customers

As a retail and commercial financial services provider it is understood that long-term success is only possible with a customer-centric business model and therefore customer impact is critical to all Board decisions. With a large number of customers, the Bank strives to treat them fairly, making it easy for them to find, understand and access products that are right for them, whatever their circumstances.

Direct engagement

The Board takes advantage of all available opportunities to engage with customers. In 2019, these included a series of branch / office visits and customer events. Customer contact enables direct feedback and informs strategic decision making. In July 2019, Lloyds Banking Group launched the reconnecting with customers pilot programme, in which the Bank participated, specifically designed to bring senior leaders across the organisation closer to customers and customer facing teams. The Chairman and a number of Non-Executive Directors also attended customer insights sessions monthly across the UK to hear directly from customers about their lives and what is important to them.

Earning and retaining the trust of customers is a priority for the Board with regular updates received. The Bank remains committed to doing whatever is necessary to ensure all customers impacted by past conduct failures receive fair recompense. Having identified the need to upgrade the skills of small businesses in technology, productivity and export opportunities, Lloyds Banking Group has been engaging with government and other organisations to provide additional support.

Indirect engagement

The Board reviews the customer dashboard, which provides a detailed insight into the Bank's performance in respect of delivering on customer related ambitions, and agreed improvements in the dashboard's construct during the course of the year. The Board also approves the annual customer plans, which set out the customer related priorities for the coming year. The Chairman, Chief Executive and other Board members regularly review customer complaints to understand areas for improvement, and review how we respond to complaints. The Board also looks to benchmark performance among customers and uses insight from a range of internal and external research, including net promoter scores and other customer indices, to improve services.

The Board received regular updates and reports on progress of the strategy, including the development of the next strategic phase, ensuring the customer remains at the heart of strategic investment. The Board receives insight and guidance in relation to the competitive environment and market shares, providing strategic insight and generating good discussion among the Board, resulting in either actions or key learnings taken in the Bank. The focus on customers is not just evidenced by the regularity of presentations to Board, but also by the existence of the Group Customer First Committee. The Committee is composed of members of senior management and regularly reports to the Board. The Committee acts as the custodian of organisation wide customer experience and has responsibility for monitoring, reviewing and challenging the divisions to make changes to support the delivery of the Bank's aim and customer-centric culture.

More information on the wider Lloyds Banking Group approach to customers, which includes the approach of the Bank, can be found on pages 16 to 18 and pages 27 to 34 in the Lloyds Banking Group annual report and accounts for 2019, available on the Lloyds Banking Group website.

Shareholders

The Bank is a wholly owned subsidiary of Lloyds Banking Group. The Directors ensure that the strategy, priorities, processes and practices of the Bank are fully aligned where required to those of Lloyds Banking Group, ensuring that the interests of Lloyds Banking Group as the Bank's sole shareholder are duly acknowledged. Further information in respect of the relationship of Lloyds Banking Group with its shareholders is included within the Strategic Report within the Lloyds Banking Group Annual Report and Accounts for 2019, available on the Lloyds Banking Group website.

Communities and the environment

As part of the largest retail and commercial financial services provider in the UK, the Bank has a presence in a large number of communities. Lloyds Banking Group, including the Bank, specifically invest in local communities across Britain to help them prosper economically and build social cohesion by tackling disadvantage. Community and environmental priorities during the year have included helping the transition to a sustainable low carbon economy, helping Britain get a home, helping people save for the future, helping businesses start up and grow and building capability and digital skills.

Direct engagement

The Board continued to support the work of Lloyds Banking Group's four charitable Foundations and during Small Charities Week, campaigns were run with each Foundation showcasing the work they do for small but vital charities including those tackling domestic abuse and mental health. This demonstrated the alignment between support for vulnerable customers and the work done by charities to support related social issues. Sara Weller, Chair of the Lloyds Banking

Group Responsible Business Committee, is a Lloyds Banking Group appointed trustee of the Lloyds Bank Foundation, England and Wales. Members of the Board visited several charities in 2019, including the Manchester Digital Academy, Angel Eyes in Northern Ireland and the Cathedral Archer project in Sheffield.

Indirect engagement
Lloyds Banking Group's Helping Britain Prosper Plan, in which the Bank participates, is reviewed and approved annually by the Board to ensure it focuses on what matters most to people, businesses and communities in the UK. The Lloyds Banking Group Responsible Business Committee, a subcommittee of the Lloyds Banking Group Board, provides oversight and support for the Helping Britain Prosper Plan, and the plans for delivering the aspiration to be seen as a trusted and responsible business.

During 2019, the Board reviewed responses from the Responsible Business materiality study which outlined a wide range of views on Lloyds Banking Group, including the Bank. These responses then informed and guided responsible business strategy and reporting.

The Board undertook various related deep dives throughout 2019, including key areas of strategic focus such as ESG, cyber security and inclusion and diversity, with specific focus on BAME colleagues. This highlighted a number of strengths but also identified opportunities for further improvement in behaviours and approach. The Board supports 10 regional ambassadors that cover the home nations of Scotland, Wales and Northern Ireland, and the seven regions of England. This programme has established strong relationships with politicians, the media, local councils and other community institutions to offer Lloyds Banking Group's and the Bank's insight on the major economic and social debates the country faces.

Lloyds Banking Group and the Bank are eager to play a part in tackling climate change, by working with stakeholders to help reduce the carbon emissions which the Bank finances, and are developing longer-term broader social impact goals during 2020, as Lloyds Banking Group develops its thinking around the Society of the Future.

Key board decision – Tackling climate change
Across the globe, action to combat climate change is needed. Lloyds Banking Group and the Bank support the Government's Clean Growth Strategy and are supporting customers with a range of initiatives to help them become more sustainable and think about environmental impacts, including access to green finance. The transition to a low carbon economy impacts us all and subsequently is a fundamental element of the Bank's strategy and core to Helping Britain Prosper.

In 2018 following a detailed review by the Board, a new sustainability metric was introduced to the Helping Britain Prosper Plan, signalling our intent and commitment and in January 2020, Lloyds Banking Group announced an ambitious new goal to help reduce the carbon emissions it and its subsidiary companies, including the Bank, finances by more than 50 per cent by 2030. More information is provided about this ambitious goal and other related commitments on pages 28 to 31 of the Lloyds Banking Group annual report and accounts for 2019, or in an approach to ESG presentation online https://www.lloydsbankinggroup.com/investors/financial-performance/

In developing proposals, various stakeholder groups have been engaged including customers, colleagues, shareholders, suppliers, government and regulators. The annual responsible business materiality study specifically identified environmental sustainability and climate change as a critical issue and as a result further detailed analysis was undertaken by Lloyds Banking Group's sustainability teams. The Responsible Business Committee of Lloyds Banking Group provides direction and oversight, whilst at Executive level, the Group Executive Sustainability Committee, supported by divisional Governance Forums and working groups, provide oversight. The Board were briefed on key climate related issues by external industry experts and also engaged on a number of external fronts.

Long-term implications
The Board acknowledges a responsibility to help drive progress towards a sustainable and resilient UK economy, taking into consideration the needs of different stakeholders and risks to the business, and were comfortable endorsing ambitious plans, given the benefit to the Bank and future generations.

Regulators and government
The Bank and its Directors have a strong, open and transparent relationship with our regulators and other government authorities including HMRC. There is regular liaison to ensure the business is aligned to the evolving regulatory framework. Areas of discussion and consideration with the regulators have included ensuring firms have robust prudential standards and supervision in place, the fair treatment of customers, adapting to market changes and horizon scanning (including climate change and developments in data and technology), matters surrounding organisational culture, financial and operational resilience, risk management, recovery and resolution and preparations for EU withdrawal.

Direct engagement
During 2019 regular meetings were held with various regulators at different levels of the organisation from Board to senior management. The Board and senior management continue to engage with the regulators through proactive meetings to discuss various key themes, such as customer-centric culture, transformation and change, operational and financial resilience and credit risk. The Chairman has had extensive dialogue with both the FCA and PRA on all aspects of their regulatory agenda.

Indirect engagement
The Board Risk Committee of Lloyds Banking Group and the Bank receives monthly updates on regulatory interaction providing a view of key areas of focus, alongside progress made addressing regulatory actions, and current enforcement activity.

Response to regulator and government priorities
The Board are committed to complying with all relevant legislation, in particular that relating to prudential and conduct regulation. Appropriate regulation is considered in all Board decision making. The Board continues to closely monitor the status of regulatory relationships, enhancing proactive engagement across key regulatory changes and areas of focus. In 2020, engagement strategy will continue to be adapted, ensuring alignment with emerging areas of focus and the regulators' business plans.

Key Board decision – EU Exit preparations
Given the Bank's UK focus, our performance is inextricably linked to the health of the UK economy and throughout 2019 the Bank continued to prepare for an EU exit. Given the importance of this topic for the Bank and the country, numerous stakeholders were engaged to inform our approach including customers, colleagues, shareholders, suppliers, regulators and government.

As part of this engagement process, the Chairman was an active member of CityUK's EU exit Steering Group, working with other major financial institutions to inform government decision making. The extended EU Exit Executive Forum was established, chaired by the Chief Financial Officer, with comprehensive cross-organisation representation, to provide an update to the Board on EU exit contingency planning. Additional updates from the EU Exit Forum were also submitted to the Board Risk Committee and the Executive level Group Risk Committee. Engagement was also undertaken with politicians, officials, media, trade and other bodies to reassure on commitments to Helping Britain Prosper.

Our decision process
The EU exit contingency plans continue to be monitored closely by the Board via specific regular updates, covering both operational status and external developments, a suite of early warning indicators and corresponding risk mitigation plans. When reviewing the possible impacts of the EU exit, the Board have given particular consideration to the Bank's strong UK focus and UK-centric strategy, with specific focus on the trading, financial, operational and reputational impacts for the Bank, as well as the cyber, physical security and fraud risks, and the continued support of customers. A programme was implemented to assess the legal impacts and risks of an EU exit (including a no deal outcome) and to identify appropriate mitigants, such as establishing EU entities to ensure continuity of certain business activities.

Long-term implications
Like all UK banks impacted by the EU exit, Lloyds Banking Group submitted contingency plans to the regulators both in the UK and elsewhere as to how we would manage potential EU exit scenarios and are well prepared to ensure continuity of our limited EU business activities at the end of transition period; new European entities have been established and are now operational. Given the vast majority of the Bank's business is in the UK, the direct impact on the Bank from leaving the EU is relatively modest.

Our approach to tax
The Bank's comprehensive and diligent approach to regulation is typified by our approach to tax, with HMRC being a key stakeholder for the Bank. As an organisation with the purpose to Help Britain Prosper, and with a significant percentage of our business subject to tax in the UK, we're proud to be a large contributor of UK tax revenues. In addition, the Bank is also a major tax collector, gathering significant sums on behalf of HMRC.

The Board recognises that tax is one of the ways in which the Bank contributes to society, therefore appropriate, prudent and transparent tax behaviour is a key component of Board responsibility. There is a clear tax policy which is part of the Board-approved risk management framework. This policy sets out clear actions for colleagues to manage tax risks. Like any business, the Bank's success rests on maintaining a good reputation, and it is understood that the way the Bank approaches its tax obligations has a powerful impact on this reputation, so finding the most responsible balance is vital. The Bank complies with the HMRC Code of Practice on Taxation for Banks and Confederation of British Industry's Statement of tax principles. Tax is also covered in our Code of Responsibility, a code that applies to every colleague, team and business in the organisation – day in, day out. The code makes tax a personal responsibility for every colleague in the Bank.

Read more about our tax strategy online https://www.lloydsbankinggroup.com/globalassets/our-group/responsible-business/reporting-centre/

Suppliers

Given the size of the organisation, there is reliance on external suppliers for a number of key services. As well as being important for future success, the Bank believes that dealing with suppliers in the right way is the right thing to do. Priorities in this regard have included ensuring that suppliers are being treated fairly and professionally during the sourcing process and have clear guidance about payment procedures. Working closely with suppliers to share expertise in developing innovative, high quality products and services and effectively managing risk is also central to the Bank's approach, as is engaging in ways that ensure the Bank achieves the best value for customers in terms of price, quality and social impact, whilst building strong, collaborative relationships and understanding the environment in which we operate so that they can meet our needs and our customers' needs. Supporting suppliers in meeting our requirements for cyber security in our supply chain has also been a key consideration.

Direct engagement
The Bank wants to improve the experience of suppliers and as such regularly seeks feedback on the on-site assurance process from suppliers in order to continually improve the process. Suppliers are encouraged to express their satisfaction or dissatisfaction to their points of contact within the Bank e.g. the supplier manager, the sourcing manager or the finance contacts. Suppliers also have access to the Speak Up line. The Bank collaborates with its suppliers on key issues, and held a supplier breakfast with a roundtable discussion on cyber, resilience and information security.

Indirect engagement
The Bank as part of Lloyds Banking Group works with a large number of suppliers of varying sizes, most in professional services sectors such as IT, cyber, operations, management consultancy, legal, HR, marketing and communication. All material contracts are subject to rigorous cost management governance and updates on key supplier risks are provided to the Board. The Board Risk Committee oversees detailed processes to assess the cybersecurity of suppliers and help them meet the Bank's security requirements.

Board approved governance has been established to ensure that the ordering processes for all expenditure allows challenge to be made in line with cost management processes, maximise the use of appropriately sourced third party suppliers and offer appropriate pre-commitment controls to minimise risks and unnecessary costs. Processes also give the opportunity to negotiate further savings with third party suppliers and facilitate such suppliers being paid in a timely manner, avoiding risk and costs associated with the use of non-approved channels.

Our response to supplier priorities
It is important that the Bank has the right framework to operate responsibly. The Sourcing and Supply Chain Management Policy of Lloyds Banking Group applies to all businesses, divisions, functions and legal entities across the organisation, including the Bank, whether based in the UK or overseas. This policy has been designed to assist in managing the inherent risk in outsourcing services, and dealing with third party suppliers.

The Bank requires suppliers to adhere to relevant policies and UK suppliers are additionally required to comply with Lloyds Banking Group's Code of Supplier Responsibility. This outlines expectations for responsible business behaviour, underpinning efforts to share and extend good practice. This policy can be found on the Lloyds Banking Group website https://www.lloydsbankinggroup.com/our-group/working-with-suppliers/

The Board has a zero tolerance attitude towards modern slavery in its supply chain, and enhancements continue to be made to address the risk of and provide specific training on human trafficking and modern slavery for specialist colleagues.

Responsible, sustainable and inclusive
As part of Lloyds Banking Group with a unique position at the heart of the British economy, the Bank embraces its responsibility to help address some of the economic, social and environmental challenges the UK faces. As part of Lloyds Banking Group the Bank is Helping Britain Prosper by delivering for our customers and communities, as a responsible, sustainable and inclusive business.

Engaging with stakeholders
Engaging and responding to stakeholders is fundamental to being a responsible business. Each year Lloyds Banking Group gathers a wide range of views through formal materiality assessment with stakeholders, including those stakeholders of the Bank, which guides both strategy and reporting. A key response to their needs is the Helping Britain Prosper Plan which focuses on critical issues including environmental sustainability, digital skills, and support for homeowners, savers and businesses, which are discussed further on pages 28, 33 and 32 of the Lloyds Banking Group annual report and accounts for 2019. Further topics highlighted by stakeholders, and discussed below, include responsible governance and accountability, support for colleagues, customer privacy and data security, and support for vulnerable customers.

Responsible governance and accountability
Creating and sustaining a values-based culture with good governance is crucial to ensuring colleagues remain engaged, well informed and can effectively deliver the Bank's strategy. Rigorous internal governance and controls, comprising numerous policies and standards, ensure that the Bank treats all stakeholders fairly, while minimising risk. The Lloyds Banking Group board level Responsible Business Committee (RBC) oversees Lloyds Banking Group's performance, including that of the Bank, as a responsible business, and delivery of sustainability strategy. Both the Board and RBC are supported by the Group Executive Committee, which is in turn supported by a dedicated Sustainability Committee.

Helping colleagues to do the right thing
All colleagues must be equipped to make the right decisions. The Bank supports this by consistently promoting and embedding related policies, processes and training. Each year as part of mandatory training, colleagues review Lloyds Banking Group's Code of Responsibility, which outlines values and behaviours, and the Anti-Bribery Policy. If colleagues witness something inappropriate, they can report the matter to the colleague conduct management team, or make use of Lloyds Banking Group's independent and confidential whistleblowing service, Speak Up. In 2019 colleagues reported 451 concerns across Lloyds Banking Group, of which 216 were formally investigated following triage, with 39 per cent of those investigations substantiated, resulting in remedial action.

The Bank works to empower colleagues and one example of this is Lloyds Banking Group's award winning behavioural experiments initiative, where colleagues test new ways of working that can lead to permanent process and policy changes, including those that improve customer satisfaction.

The Bank understands that engagement is a two way process, so each year colleagues are asked to share their views via Lloyds Banking Group's independently run colleague survey, and participate in the annual Banking Standards Board Culture Assessment.

All colleagues receive a competitive and fair reward package. To encourage ownership, colleagues are eligible to participate in HMRC approved Lloyds Banking Group share plans. Further information can be found on page 116 of the Lloyds Banking Group annual report and accounts for 2019.

Protecting our customers' finances and data
Customers trust the Bank to keep their money and data safe, and the Bank deploys sophisticated technology to protect both. In addition, the Bank as part of Lloyds Banking Group plays a significant role in the Joint Fraud Taskforce, a collaboration between Government and industry, and champions the Banking Protocol, which enables colleagues to request immediate police support for at-risk customers.

The Bank also works continuously to bolster defences against cyber-attacks, paying particular attention to reducing the risks that vulnerable people face. Lloyds Banking Group is a founding member of the Financial Services Cyber Collaboration Centre, working with the Government's National Cyber Crime Centre, and the Cross-Market Operational Resilience Group. Lloyds Banking Group also work closely with other banks, recognising the importance of collaboration when it comes to security, including being part of the Cyber Defence Alliance (CDA), and meets all of the requirements set out in the EU General Data Protection Regulation (GDPR). While there's much the Bank can do, customers play a significant role in keeping their accounts secure. Public awareness campaigns are therefore crucial, and Lloyds Banking Group supports the 'Take Five' campaign, while also training colleagues so that they can help protect customers.

Supporting vulnerable customers
Vulnerability for customers exists in many forms, from a specific life event to something long-term. That's why the Bank as part of Lloyds Banking Group is committed to raising awareness, fighting stigma and providing meaningful support across a range of challenging issues. Whether supporting customers' financial worries following a cancer diagnosis, with partners at Macmillan, or working with Hope for Justice to provide bank accounts for modern slavery survivors, the Bank continues to create innovative solutions for customers. Another example is the development of a domestic and financial abuse team, Lloyds Banking Group's contribution to a very complex issue that can impact a wide range of customers. Lloyds Banking Group has also signed up to the Financial Abuse Code of Practice, and signposts the free-to-download Bright Sky app, that provides comprehensive support to people affected by domestic abuse.

In 2019, Lloyds Banking Group was the first bank to sign up to the Mental Health Accessibility Standards, supporting customers with mental health problems. For customers at risk of gambling related harm, controls have been enabled on all of the Bank's credit and debit cards. Work was also undertaken building on internal controls to run a pilot in partnership with Gamban, that helps restrict access to gambling websites and applications worldwide to provide further assistance.

Our Helping Britain Prosper Plan
Addressing some of the social, economic and environmental challenges facing the UK is the foundation of Lloyds Banking Group's Helping Britain Prosper Plan, in which the Bank participates. The plan goes beyond business as usual, uniting the organisation behind an inspiring set of objectives. Launched in 2014 and reviewed annually, the plan focuses on the areas where Lloyds Banking Group believes it can make the biggest difference. In 2018, as part of its inclusion in the Lloyds Banking Group Balanced Scorecard, specific targets were set across seven areas of focus aligned to the organisations three year strategy, including environmental sustainability, and progress is outlined below. Read more online https://www.lloydsbankinggroup.com/our-group/responsible-business/prosper-plan/

The Principles for Responsible Business
In September 2019, Lloyds Banking Group became a founding signatory of the United Nations Environment Programme Finance Initiative (UNEP FI) Principles for Responsible Banking. This sets out a framework for a reformed banking system that will better meet the changing expectations of society. Through both

responsible business activities and the Helping Britain Prosper Plan, Lloyds Banking Group is supporting the UN's broader sustainable development agenda, and contributing towards reaching the UN Sustainable Development Goals (SDGs).

Progress against the Helping Britain Prosper Plan for 2019 and related targets for 2020 can be found on page 27 of the Lloyds Banking Group annual report and accounts for 2019.

Emerging risks

The Lloyds Banking Group considers the following to be risks that have the potential to increase in significance and affect the performance of the Lloyds Banking Group.

The rapid pace and scale of measures to contain a major health issue such as the Coronavirus pandemic demonstrate the potentially adverse impact of those measures on the economy. The potential adverse impact on the value and trading of stocks, bond yields, credit spreads and commodities can also be seen in significant market falls, reduced liquidity and rises in volatility. The government and regulators are taking significant action to address the economic impact, which may be temporary, but depending on the severity it could lead to a significant loss of output and recession in the UK. Any sector-specific or wider impact due to this could potentially impact the retail or corporate customers of the Lloyds Banking Group and as a result have a material adverse effect on the Lloyds Banking Group's results of operations, financial condition or prospects.

Following the UK's exit from the EU, significant negotiation is now required on the terms of the future trade agreement. As a result, the possibility of a limited or no deal at the end of the transition period remains and could manifest in prolonged business uncertainty across the UK, including in the financial services sector. This continued lack of clarity over the UK's relationship with the EU and other foreign countries, and ongoing challenges in the Eurozone, including weak growth, raise additional uncertainty for the UK's economic outlook. There also remains the possibility of a further referendum on Scottish independence.

Any adverse changes affecting the economies of the countries in which the Lloyds Banking Group has significant direct and indirect credit exposures and any further deterioration in global macroeconomic conditions, including as a result of geopolitical events, global health issues, acts of war or terrorism, could have a material adverse effect on the Lloyds Banking Group's results of operations, financial condition or prospects.

As a result of the global health issues, the potential for operational risks materialising increases, notably in the areas of cyber, fraud, people, technology, operational resilience and where there is reliance on third-party suppliers. In addition to the key operational risks, new risks are likely to arise as the business will need to change its ways of working whilst managing any site contamination to ensure continuity and support to colleagues and customers.

The Lloyds Banking Group also considers regulatory and legal, climate, cyber, competition, data, macroeconomic headwinds, geopolitical, financial services transformation impact on customers and transition from IBORs to alternative risk free reference rates risks to have the potential to increase in significance and affect the performance of the Lloyds Banking Group. More information can be found on pages 133 to 134 of the Lloyds Banking Group annual report and accounts for 2019, available on the Lloyds Banking Group website.

Principal risks and uncertainties
Principal risks and uncertainties are reported regularly to the Lloyds Banking Group Board Risk Committee. Change / execution, data and operational resilience have been elevated from existing risks to principal risks during 2019, and strategic added as a new principal risk.

New – Change / Execution
The risk that, in delivering the Group's change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within its approved risk appetite.

Mitigation
- Continued focus on strengthening the control environment, maturation of the change policy and associated policies and procedures, which set out the principles and key controls that apply across the business and are aligned to the Lloyds Banking Group risk appetite. Senior Management continue to drive improvements to Change and Execution Risk metrics, in particular those affecting customers and colleagues.
- Businesses assess the potential impacts of undertaking any change activity on their ability to execute effectively, and the potential consequences for the existing risk profiles.

New – Data
The risk that the Group fails to effectively govern, manage, and control its data (including data processed by third party suppliers) leading to unethical decisions, poor customer outcomes, loss of value to the Group and mistrust.

Mitigation
- Significant investment has been made to enhance the maturity of data risk management in recent years.
- In addition to the General Data Protection programme which delivered the necessary infrastructure to achieve compliance with the new regulations in May 2018, a number of other large investments have been made.

New – Operational Resilience
The risk that the Group fails to design resilience into business operations, underlying infrastructure and controls (people, process, technology) so that it is able to withstand external or internal events which could impact the continuation of operations, and fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

Mitigation
- Lloyds Banking Group has increased its focus on operational resilience and has updated its strategy to reflect changing priorities of both customers and regulators.

New – Strategic
The risks which result from strategic plans which do not adequately reflect trends in external factors, ineffective business strategy execution, or failure to respond in a timely manner to external environments or changes in stakeholder behaviours and expectations.

Mitigation
- Continued digitisation of customer journeys, thereby enabling the delivery of market leading customer experiences that are seamless, accessible and personal.
- Robust operating and contingency planning to ensure potential impacts of strategic initiatives and external drivers are mitigated.

Credit
The risk that parties with whom the Group has contracted, fail to meet their financial obligations (both on and off balance sheet).

Mitigation
- Prudent, through the cycle credit principles, risk policies and appetite statements.
- Robust models and controls.

Regulatory and Legal
The risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

Mitigation
- Lloyds Banking Group policies and procedures set out the principles and key controls that should apply across the business which are aligned to the Lloyds Banking Group risk appetite.
- Business units identify, assess and implement policy and regulatory requirements and establish local controls, processes, procedures and resources to ensure appropriate governance and compliance.

Conduct
The risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

Mitigation
- Simplified and enhanced conduct policies and procedures in place to ensure appropriate controls and processes that deliver fair customer outcomes, and support market integrity and competition requirements.
- Active engagement with regulatory bodies and other stakeholders to develop understanding of concerns related to customer treatment, effective competition and market integrity, to ensure that Lloyds Banking Group's strategic conduct focus continues to meet evolving stakeholder expectations.

Operational
The risk of loss from inadequate or failed internal processes, people and systems, or from external events.

Mitigation
- Lloyds Banking Group continues to review and invest in its control environment to ensure it addresses the inherent risks faced.
- Lloyds Banking Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (including insurance) and acceptance.

People
The risk that the Group fails to provide an appropriate colleague and customer-centric culture, supported by robust reward and wellbeing policies and processes; effective leadership to manage colleague resources; effective talent and succession management; and robust control to ensure all colleague-related requirements are met.

Mitigation
- Focusing on leadership and colleague engagement, through delivery of strategies to attract, retain and develop high calibre people together with implementation of rigorous succession planning.
- Continued focus on Lloyds Banking Group's culture by developing and delivering initiatives that reinforce the appropriate behaviours which generate the best possible long-term outcomes for customers and colleagues.

Capital
The risk that we have a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across Lloyds Banking Group.

Mitigation
- Lloyds Banking Group has a capital management framework that includes the setting of capital risk appetite and dividend policy.
- Lloyds Banking Group maintains a recovery plan which sets out a range of potential mitigating actions that could be taken in response to a stress.

Funding and Liquidity
Funding risk is the risk that we do not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity risk is the risk that we do not have sufficient financial resources to meet our commitments when they fall due, or can only secure them at excessive cost.

Mitigation
- Lloyds Banking Group manages and monitors liquidity risks and ensures that liquidity risk management systems and arrangements are adequate with regard to the internal risk appetite, Lloyds Banking Group strategy and regulatory requirements.
- Lloyds Banking Group's funding and liquidity position is underpinned by its significant customer deposit base, and is supported by strong relationships across customer segments.

Governance
The risk that the Group's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

Mitigation
- Defining individual and collective accountabilities for risk management, risk oversight and risk assurance through a three lines of defence model which supports the discharge of responsibilities to customers, shareholders and regulators.
- Outlining governance arrangements which articulate the enterprise-wide approach to risk management.

Market
The risk that the Group's capital or earnings profile is affected by adverse market rates, in particular interest rates and credit spreads in the banking business, and credit spreads in the Group's defined benefit pension schemes.

Mitigation
- Structural hedge programmes implemented to manage liability margins and margin compression.
- Equity and credit spread risks are closely monitored and, where appropriate, asset and liability matching is undertaken.
- Lloyds Banking Group's defined benefit pension schemes continue to monitor their credit allocation as well as the hedges in place against nominal rate and inflation movements.

Model
The risk of financial loss, regulatory censure, reputational damage or customer detriment, as a result of deficiencies in the development, application and ongoing operation of models and rating systems.

Mitigation
- The model risk management framework, established by and with continued oversight from an independent team in the Risk division, provides the foundation for managing and mitigating model risk within Lloyds Banking Group.

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 notes 40 and 43 to the accounts. The Group's approach to risk management including risk policies, risk appetite, measurement bases and sensitivities, in particular for credit risk, market risk and liquidity risk, is aligned to those of Lloyds Banking Group plc, the Bank's ultimate parent. Further information can be found in the Lloyds Banking Group plc annual report.

The Group maintains risk management systems and internal controls relating to the financial reporting processes designed to:

– ensure that accounting policies are appropriately and consistently applied;
– enable the calculation, preparation and reporting of financial outcomes in line with applicable standards; and
– ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements.

The 2019 Strategic Report has been approved by the Board of Directors.

On behalf of the Board

Lord Blackwell
Bank of Scotland plc
23 March 2020

Results
The consolidated income statement on page 26 shows a statutory profit before tax from continuing operations for the year ended 31 December 2019 of £1,278 million (year ended 31 December 2018: £2,231 million).

Dividends
During the year the Bank paid an interim dividend of £500 million (2018: a cumulative total of £3,000 million). The Directors have not recommended a final dividend for the year ended 31 December 2019 (2018: nil).

Post balance sheet events
Details of post balance sheet events are given in note 48.

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 and liquidity. 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 the principal risks and uncertainties and capital and funding position set out in the Strategic Report on pages 2 to 12 and additionally have considered projections for the Bank's and the Group's capital and funding position. Accordingly, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the accounts over the next 12 months, from the date of approval of the financial statements.

Corporate Governance Statement
In accordance with the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018) (the 'Regulations'), for the year ended 31 December 2019, the Bank has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the 'Principles'), which are available at frc.org.uk. The following section explains the Bank's approach to corporate governance, and its application of the Principles.

Fundamental to the Bank's strategy are high standards of corporate governance. A Corporate Governance Framework is in place for Lloyds Banking Group, the Bank, Lloyds Bank plc and HBOS plc, with all four companies sharing a common approach to governance. The framework is designed to meet the specific needs of each company, setting the wider approach and applicable standards in respect of the Bank's corporate governance practices, including addressing the matters set out in the Principles and the governance requirements of the operation of the Bank as part of Lloyds Banking Group's Ring Fenced Bank.

This includes the matters reserved to the Board, and the matters the Board has chosen to delegate to management, including decision making on operational matters such as those relating to credit, liquidity and the day to day management of risk. Governance arrangements, including the Corporate Governance Framework, are reviewed at least annually to ensure they remain fit for purpose. The Corporate Governance Framework of the Bank further addresses the requirements of the Principles as follows.

Membership of the Board and its committees as at 31 December 2019 comprised:

Board and Committee Composition and Board Attendance in 2019[1]

Board Member[5]	Board meetings	Nomination Committee	Audit Committee	Board Risk Committee	Remuneration Committee
Lord Blackwell (C)	11/11	7/7 (C)	–	8/8	6/6
António Horta–Osório	11/11	–	–	–	–
William Chalmers[2]	3/3	–	–	–	–
Juan Colombás	11/11	–	–	–	–
George Culmer[2]	8/8	–	–	–	–
Sarah Bentley	11/11	–	–	8/8	6/6
Alan Dickinson	11/11	7/7	6/6	8/8 (C)	5/6[4]
Anita Frew	11/11	7/7	6/6	8/8	6/6
Brendan Gilligan	11/11	–	6/6	8/8	–
Simon Henry	10/11[4]	–	6/6 (C)	7/8[4]	–
Nigel Hinshelwood	11/11	7/7	6/6	8/8	6/6
Sarah Legg[3]	–	–	–	–	–
Lord Lupton	11/11	–	3/3	8/8	–
Amanda Mackenzie	11/11	–	–	8/8	3/3
Nick Prettejohn	11/11	5/5	6/6	8/8	–
Stuart Sinclair	11/11	–	–	8/8	6/6 (C)
Sara Weller	11/11	7/7	–	7/8[4]	6/6

C - Chairman

1 Where a Director is unable to attend a meeting s/he receives papers in advance and has the opportunity to provide comments to the Chairman of the Board or the relevant Committee Chairman.

2 George Culmer retired from, and William Chalmers was appointed to, the Board on 1 August 2019.

3 Sarah Legg joined the Board and respective Committees on 1 December 2019. There were no meetings in December 2019.

4 Unable to attend due to a scheduling clash with a prior business commitment.

5 Catherine Woods joined the Board and respective Committees on 1 March 2020.

The Board delegates further responsibilities to the Group Chief Executive, who is supported by the Group Executive Committee, the composition of which is detailed on pages 68 to 69 of the Lloyds Banking Group annual report and accounts for 2019.

Principle One – Purpose and Leadership
The Board is collectively responsible for the long term success of the Bank. It achieves this by agreeing the Bank's strategy, within the wider strategy of Lloyds Banking Group, and overseeing delivery against it. The Bank's strategy is discussed further in the Strategic Report on pages 2 to 12. The Board also assumes responsibilities for the management of the culture, values and wider standards of the Bank, within the equivalent standards set by Lloyds Banking Group.

Consideration of the needs of all stakeholders is fundamental to the way the Bank operates, as is maintaining the highest standards of business conduct, which along with ensuring delivery for customers is a vital part of the corporate culture. The Bank's approach is further influenced by the need to build a culture in which everyone feels included, empowered and inspired to do the right thing for customers. To this end, the Board plays a lead role in establishing, promoting and monitoring the Bank's corporate culture and values, with the Corporate Governance Framework ensuring such matters receive the level of prominence in Board and Executive decision making which they require. The Bank's corporate culture and values align to those of Lloyds Banking Group, which are discussed in more detail on pages 14 to 35 of the Lloyds Banking Group annual report and accounts for 2019.

Principle Two – Board Composition
The Bank is led by a Board comprising a Non-Executive Chairman, independent Non-Executive Directors and Executive Directors, further details of the Directors can be found on page 17. The Board considers its composition regularly, and is committed to ensuring it has the right balance of skills and experience. The Board considers its current size and composition is appropriate to the Bank's circumstances. The Board places great emphasis on ensuring its membership reflects diversity in its broadest sense. New appointments are made on merit, taking account of the specific skills and experience, independence and knowledge needed to ensure a rounded board and the diversity benefits each candidate can bring overall. There are a range of initiatives within Lloyds Banking Group more widely to help provide mentoring and development opportunities for female and BAME executives, and to ensure unbiased career progression opportunities. Progress on diversity objectives is monitored by the Board and built into its assessment of executive performance.

The Board is supported by its committees, the operation of which are discussed below, which make recommendations to the Board on matters delegated to them, in particular in relation to internal control, risk, financial reporting and remuneration matters. Each committee has written terms of reference setting out its delegated responsibilities. Each committee comprises Non-Executive Directors with appropriate skills and experiences and is chaired by an experienced chairman. The committee chairs report to the Board at the next Board meeting. The Board undertakes an annual review of its effectiveness, which provides an opportunity to consider ways of identifying greater efficiencies, ways to maximise strengths and highlights areas of further development. The effectiveness review is commissioned by the Board, assisted by the Company Secretary. In addition to considering the effectiveness of the Board, the effectiveness of the Board committees and individual Directors is also considered, with individual performance evaluation conducted for each of the members of the Board.

Principle Three – Director Responsibilities
The Directors assume ultimate responsibility for all matters, and along with senior management are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation through the Corporate Governance Framework. Policies are also in place in relation to potential conflicts of interest which may arise.

The Board is supported by its committees which make recommendations on matters delegated to them under the Corporate Governance Framework. The management of all committees is in keeping with the basis on which meetings of the Board are managed, with open debate, and adequate time for members to consider proposals which are put forward. The Chairman of the Board and each Board committee assumes responsibility with support from the Company Secretary for the provision to each meeting of accurate and timely information.

Principle Four – Opportunity and Risk
The Board oversees the development and implementation of the Bank's strategy, within the context of the wider strategy of Lloyds Banking Group, which includes consideration of all strategic opportunities. The Board is also responsible for the long term sustainable success of the Bank, generating value for its shareholders and ensuring a positive contribution to society. The Board agrees the Bank's culture, purpose, values and strategy, within that of Lloyds Banking Group, and agrees the related standards of the Bank, again within the relevant standards of Lloyds Banking Group. Further specific aims and objectives of the Board are formalised within the Corporate Governance Framework.

Strong risk management is central to the strategy of the Bank, which along with a robust risk control framework acts as the foundation for the delivery of effective management of risk. The Board agrees the Bank's risk appetite and ensures the Bank manages risk effectively, delegating related authorities to individuals through the Corporate Governance Framework and the further management hierarchy. Board level engagement, coupled with the direct involvement of senior management in risk issues ensures that escalated issues are promptly addressed and remediation plans are initiated where required. The Bank's risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of Lloyds Banking Group, and as such are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Bank's principal risks are discussed further on pages 10 to 12.

Principle Five – Remuneration
The Remuneration Committee of the Board, in conjunction with the Remuneration Committee of Lloyds Banking Group (the 'Remuneration Committees'), assume responsibility for the Bank's approach to remuneration. This includes reviewing and making recommendations on remuneration policy as relevant to the Bank, including the remuneration of Directors, members of the Executive and colleagues where the regulators require the Bank to implement a specific approach to their remuneration, such as Senior Managers and other material risk takers. The activities of the Remuneration Committees extend to matters of remuneration relevant to subsidiaries of the Bank, where such subsidiary does not have its own remuneration committee. Certain members of the Lloyds Banking Group Executive, including the Group People and Productivity Director, are authorised to act upon the decisions made by the Remuneration Committees, and to undertake such other duties relevant to remuneration as delegated to them.

Principle Six – Stakeholders
The Bank as part of Lloyds Banking Group operates under Lloyds Banking Group's wider Responsible Business approach, which acknowledges that the Bank has a responsibility to help address the economic, social and environmental challenges which the UK faces, and as part of this understand the needs of the Bank's external stakeholders, including in the development and implementation of strategy. Central to this is Lloyds Banking Group's Helping Britain Prosper plan, in which the Bank participates, which seeks to gather stakeholder views through a dedicated materiality study, as overseen by Lloyds Banking Group's board level Responsible Business Committee.

In 2019, the Responsible Business Committee determined that the Bank and Lloyds Banking Group continued to demonstrate responsibility as a key priority, including keeping customers' data safe, supporting vulnerable customers, lending responsibly, supporting businesses and working with suppliers. The approach of the Board in respect of its all stakeholders is described further in a separate statement made in compliance with the Regulations on pages 5 to 9.

Directors' report

Directors
The names of the current Directors are shown on page 17. Changes to the composition of the Board since 1 January 2019 up to the date of this report are shown in the table below. Anita Frew will retire at the forthcoming Lloyds Banking Group AGM.

	Joined the Board	Retired from the Board
Sarah Bentley	1 January 2019	
Brendan Gilligan	1 January 2019	
Nigel Hinshelwood	1 January 2019	
William Chalmers	1 August 2019	
George Culmer		1 August 2019
Sarah Legg	1 December 2019	
Catherine Woods	1 March 2020	

Directors' indemnities
The Directors of the Bank, including the former Director who retired during the year, have entered/will enter into individual deeds of indemnity with Lloyds Banking Group plc which constitute 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force. The deeds were in force during the whole of the financial year or from/will be from the date of appointment in respect of the Directors appointed in 2019 and 2020. In addition, Lloyds Banking Group plc had appropriate Directors' and Officers' liability insurance cover in place throughout 2019. Deeds for existing Directors are available for inspection at the Bank's registered office.

Lloyds Banking Group plc has also granted deeds of indemnity by deed poll and by way of entering into individual deeds, which constitute 'qualifying third party indemnity provisions' to the Directors of the Group's subsidiary companies, including former Directors who retired during the year, and to colleagues subject to the provisions of the Senior Managers and Certification Regime. Such deeds were in force during the financial year ended 31 December 2019 and remain in force as at the date of this report. Qualifying pension scheme indemnities have also been granted to the Trustees of Lloyds Banking Group's Pension Schemes, including those schemes relevant to the Bank, which were in force for the whole of the financial year and remain in force as at the date of this report.

Information required under DTR 7.2
Certain information is incorporated into this report by reference. Information about internal control and risk management systems relating to the financial reporting process can be found on page 12.

Information about share capital is shown in note 31 on pages 74 to 75. The Bank is a wholly owned subsidiary of HBOS plc, which holds all of the Bank's issued ordinary share capital.

The Directors manage the business of the Bank under the powers set out in the Companies Act 2006 and the Bank's articles of association, these power include those in relation to the issue or buy back of the Bank's shares.

The appointment and retirement of Directors is governed by the Bank's articles of association and the Companies Act 2006. The Bank's articles of association may only be amended by a special resolution of the shareholders in a general meeting.

Conflicts of interest
The Board has a comprehensive procedure for reviewing, and as permitted by the Companies Act 2006 and the Bank's articles of association, approving actual and potential conflicts of interest. Directors have a duty to notify the Chairman and Company Secretary as soon as they become aware of actual or potential conflict situations. Changes to commitments of all Directors are reported to the Board and a register of potential conflicts and time commitments is regularly reviewed and authorised by the Board to ensure the authorisation status remains appropriate.

Stuart Sinclair is a Senior Independent Director at QBE UK Limited, a general insurance and reinsurance company. Lord Lupton is a senior advisor to Greenhill Europe, an investment bank focused on providing financial advice on significant mergers, acquisitions, restructurings, financings and capital raising to corporations, partnerships, institutions and governments. The Board has recognised that potential conflicts may arise as a result of these positions. The Board has authorised the potential conflicts and requires Mr. Sinclair and Lord Lupton to recuse themselves from discussions, should the need arise.

Branches, future developments and financial risk management objectives and policies
The Bank provides a wide range of banking and financial services through branches and offices in the UK and overseas. Information regarding future developments and financial risk management objectives and policies of the Group in relation to the use of financial instruments that would otherwise be required to be disclosed in the Directors' report, and which is incorporated into this report by reference, can be found in the Strategic Report.

Share capital
Information about share capital is shown in note 31 on pages 74 to 75. This information is incorporated into this report by reference. The Bank did not repurchase any of its shares during 2019 (2018: none). There are no restrictions on the transfer of shares in the Bank other than set out in the articles of association and certain restrictions which may from time to time be imposed by law and regulations.

Change of control
The Bank is not party to any significant agreements which take effect, alter or terminate upon a change of control of the Bank following a takeover bid. There are no agreements between the Bank and its Directors or employees providing compensation for loss of office or employment that occurs because of a takeover bid.

Research and development activities
During the ordinary course of business the Bank develops new products and services within the business units.

Directors' report

Information incorporated by reference
The following additional information forms part of the Directors' Report, and is incorporated by reference.

Content		Pages
Disclosures required under the Large and Medium–sized Companies and Groups (Accounts and Reports) Regulations 2008	Statement of stakeholder engagement	5 – 9

Significant contracts
Details of related party transactions are set out in note 37 on pages 80 to 82.

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 Bank and Group 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 Bank and the Group and of the profit or loss of the Bank and the 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 and, as regards the Group financial statements, Article 4 of the IAS Regulation. 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, who are in office as at the date of this report and whose names are shown on page 17 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 and the profit or loss of the Bank and the Group; and
– the management report contained in the Strategic Report and the Directors' Report includes a fair review of the development and performance of the business and the position of the Bank and Group, together with a description of the principal risks and uncertainties that they face.

The Directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Bank's position and performance, business model and strategy. The Directors have also separately reviewed and approved the Strategic Report.

Independent auditor 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 auditor is 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 auditor is 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 2020 annual general meeting to re-appoint PricewaterhouseCoopers LLP as auditor. The Bank's Audit Committee is satisfied that the external auditor remains independent and effective.

On behalf of the Board

Kate Cheetham
Company Secretary
23 March 2020

Bank of Scotland plc
Registered in Scotland
Company Number SC327000

Directors

Lord Blackwell *Chairman*

António Horta-Osório *Executive Director and Group Chief Executive*

William Chalmers *Executive Director and Chief Financial Officer* (from 1 August 2019)

Juan Colombás *Executive Director and Chief Operating Officer*

Sarah Bentley (from 1 January 2019)

Alan Dickinson

Anita Frew

Brendan Gilligan (from 1 January 2019)

Simon Henry

Nigel Hinshelwood (from 1 January 2019)

Sarah Legg (from 1 December 2019)

Lord Lupton CBE

Amanda Mackenzie

Nick Prettejohn

Stuart Sinclair

Sara Weller CBE

Catherine Woods (from 1 March 2020)

Forward looking statements

This document contains certain forward looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Bank of Scotland plc together with its subsidiaries (the Group) and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements.

Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements.

Examples of such forward looking statements include, but are not limited to: projections or expectations of the Group's future financial position including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; statements of plans, objectives or goals of the Group or its management including in respect of statements about the future business and economic environments in the UK and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future.

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

Lloyds Banking Group may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds Banking Group annual reviews, half-year announcements, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group to third parties, including financial analysts.

Except as required by any applicable law or regulation, the forward looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF BANK OF SCOTLAND PLC

Report on the audit of the financial statements

Opinion

In our opinion, the financial statements of Bank of Scotland plc (the Group) and the Bank financial statements (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 2019 and of the Group's profit and the Group's and the Bank's cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Bank's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- 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.

We have audited the financial statements, included within the Report and Accounts (the "Annual Report"), which comprise: the balance sheets at 31 December 2019; the consolidated income statement and the statements of comprehensive income for the year then ended; the statements of changes in equity for the year then ended; and the cash flow statements for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Bank.

We have provided no non-audit services to the Group or the Bank in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview

- Overall Group materiality: £120 million (2018: £150 million), based on 5 per cent of profit before tax, adjusted to remove the effects of certain items which were considered to have a disproportionate impact.
- Overall Bank materiality: £120 million (2018: £150 million), based on 1 per cent of total assets but limited to the overall Group materiality.
- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).
- We performed audit procedures over components considered financially significant in the context of the Group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances). We performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to address the risk of material misstatement in the residual components.

The key audit matters which in our professional judgement were of most significance in the audit and involved the greatest allocation of our efforts and resources:

- Allowance for Expected Credit Losses (ECL) (Group and Bank)
- Payment Protection Insurance (PPI) (Group and Bank)
- Hedge accounting (Group and Bank)
- Privileged access to IT systems (Group and Bank)
- Potential impact of Coronavirus (Group and Bank)

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of banking laws and regulations such as, but not limited to, regulations relating to consumer credit and unethical and prohibited business practices, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006, Consumer Credit Act 1974 and Banking Reform Act 2013. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting manual journal entries to manipulate financial performance, management bias through judgements and assumptions in significant accounting estimates and significant one-off or unusual transactions. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

- Discussions with management and those charged with governance including consideration of known or suspected instances of non-compliance with laws and regulations and fraud;
- Evaluation and testing of the operating effectiveness of management's entity level controls designed to prevent and detect irregularities, in particular their code of conduct and whistleblowing helpline;
- Assessment of matters reported on the Group's whistleblowing helpline and the results of management's investigation of such matters;
- Performing testing over period end adjustments;
- Incorporating unpredictability into the nature, timing and/or extent of our testing;

- Reviewing key correspondence with the FCA and PRA;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the allowance for ECL; the provision for PPI; and hedge accounting (see related key audit matters below); and
- Identifying and testing journal entries, in particular any manual journal entries posted by infrequent users or senior management, posted on unusual days, posted with descriptions indicating a higher level of risk, or posted late with a favourable impact on financial performance.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Allowance for Expected Credit Losses (ECL) **Group and Bank** *Refer to page 34 (Note 2: Accounting policies), page 40 (Note 3: Critical accounting judgements and estimates) and page 61 (Note 17: Allowance for impairment losses).* The determination of the allowance for ECL is a judgemental area. A number of judgements and assumptions are outlined in the financial statements, including the definition of significant increases in credit risk and the application of forward looking information. *Group economics* The Group's economics team develops future economic scenarios. The base case economic scenario is determined through the application of judgement, and the outer scenarios are generated and selected through the use of a statistical model. The four economic scenarios represent distinct parts of the loss distribution which is developed based on historical experience. The scenarios, together with their weightings, are provided to the Retail and Commercial Banking divisions for incorporation into the calculation of the allowance for ECL. *Retail* The allowance for ECL relating to loans and advances in the Retail division is determined on a collective basis, with the use of impairment models. These models use a number of key assumptions including probability of default, loss given default (including propensity for possession and forced sale discounts for mortgages) and valuation of recoveries. Management also apply overlays where they believe the model calculated assumptions and allowances are not appropriate, either due to emerging trends or the model limitations. An example of this is an overlay to the impairment model output for the UK mortgages portfolio relating to ECL on past term interest only exposures. Our work therefore focused on the appropriateness of modelling methodologies adopted and significant judgements made in determining overlays as well as the measurement of those overlays. *Commercial Banking* The allowance for ECL relating to credit impaired loans and advances (referred to herein also as being in Stage 3) in the Commercial Banking division is primarily estimated on an individual basis. Judgement is required to determine when a loan is considered to be credit impaired, and then to estimate the expected future cash flows related to that loan under multiple weighted scenario outcomes. An allowance for ECL is determined for Commercial Banking loans and advances which are not classified as being credit impaired at the reporting date (referred to as being in Stages 1 and 2) using impairment models based on key assumptions including probability of default and loss given default. Management apply overlays to the modelled output to address methodology and data limitations, or risks not captured by the model.	*Group economics* We understood management's process and tested key controls relating to the generation, selection and weighting of economic scenarios. We engaged our internal economic experts and actuarial modelling specialists to assist us as we considered: – The approach to the determination of the base case economic scenario; – The identification and use of appropriate external economic data; – The approach to the generation and selection of economic scenarios representing the upside, downside and severe downside; – The operation of the Group's internally developed statistical model; and – The review, challenge and approval of the economic scenarios by the Group's governance processes. We found the key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit. We critically assessed the assumptions adopted in the base case economic scenario by comparing them to our independent view of the economic outlook and market consensus data. We investigated any economic variables outside of our thresholds. We also assessed the risk of bias in the forecasts, as well as the existence of contrary evidence. We independently re-performed the Group's model and performed testing to evaluate the level of non-linearity captured in the allowance for ECL. We also assessed the appropriateness of the weightings adopted. Based on the evidence obtained, we consider that the economic scenarios adopted reflect an unbiased, probability weighted view, that appropriately captures the impact of non-linearity. *Retail* We understood management's process and tested key controls around the determination of the allowance for ECL, including controls relating to: – Appropriateness of modelling methodologies and monitoring of model performance; – Periodic model review, validation and approval; – The identification of credit impairment events; and – The review, challenge and approval of the allowances for ECL, including the impairment model outputs, key management judgements and overlays applied. We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.

We understood and assessed the appropriateness of the impairment models developed and used by management. This included assessing and challenging the appropriateness of key modelling judgements (e.g. criteria used to determine significant increase in credit risk) and quantifying the impact of the use of proxies and simplifications, assessing whether these were appropriate. For selected portfolios, we created our own independent models covering certain parts of the model calculation which enabled us to re-perform management's calculation and challenge their outputs.

We tested the completeness and accuracy of key data inputs, sourced from underlying systems that are applied in the calculation. We tested the reconciliation of loans and advances between underlying source systems and the ECL models.

We performed testing over the measurement of the overlays in place, focusing on the larger overlays and those which we considered to represent the greatest level of audit risk (e.g. overlays relating to past term interest-only exposures). We assessed the appropriateness of methodologies used to determine and quantify the overlays required and the reasonableness of key assumptions.

Based on our knowledge and understanding of the weaknesses and limitations in management's models and industry emerging risks, we critically assessed the completeness of the overlays proposed by management.

We used credit risk modelling specialists to support the audit team in the performance of these audit procedures.

Commercial Banking
We understood management's process and evaluated and tested key controls around the determination of the allowance for ECL.

For the Stage 1 and 2 allowance, we focused on:

– The identification and assessment of the completeness and accuracy of critical data applied in the ECL calculation;
– The governance over the ECL determination, including the validation of the ECL methodology, assumptions and inputs, and the annual model performance validation; and
– The review, challenge and approval processes in place to assess the overall reasonableness of the allowance for ECL.

For the Stage 3 allowance, we focused on:

– The controls in place for the identification of credit impaired loans and subsequent transfer of these cases to the credit loss assessment team; and
– The review, challenge and approval processes that are in place to assess the overall reasonableness of the allowance for ECL.

We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit.

We performed the following procedures over the Stage 1 and 2 allowance for ECL:

– We critically assessed whether the methodology applied in the calculation is compliant with IFRS 9;
– We tested the formulae applied within the calculation, including the appropriateness, and application of, the quantitative and qualitative criteria used to assess significant increases in credit risk;
– We tested the completeness and accuracy of key data inputs, sourced from underlying systems that are applied in the calculation;
– We tested the reconciliation of loans and advances between underlying source systems and the allowance models; and
– We critically assessed the impact of identified model limitations and the completeness of overlays applied by management.

We performed the following procedures to test the completeness of credit impaired assets requiring a Stage 3 allowance for ECL:

– We critically assessed the criteria for determining whether a credit impairment event had occurred; and

	– We tested a risk based sample of Stage 1 and 2 loans, utilising industry and insolvency specialists to support the audit team in identifying sectors or types of borrowers with an elevated risk of weaker financial performance or distress. For each risk based sample, as well as an additional haphazardly selected sample of Stage 1 and 2 loans, we independently assessed whether there was evidence indicating a credit impairment event (e.g. a customer experiencing financial difficulty or in breach of covenant) and therefore whether they were appropriately categorised. For a sample of Stage 3 credit impaired loans, we: – Evaluated the basis on which the allowance was determined, and the evidence supporting the analysis performed by management; – We independently challenged whether the key assumptions used, such as the recovery strategies, collateral rights and ranges of potential outcomes, were appropriate, given the borrower's circumstances; – Re-performed management's allowance calculation, assessing supporting evidence in relation to key inputs on a case by case basis, that included expected future cash flows, discount rates, valuations of collateral held, and the weightings applied to scenario outcomes; and – Where relevant, specifically considered whether valuations were up to date, and consistent with the strategy being followed in respect of the particular borrower and assessed the sensitivity to key assumptions used. Based on the evidence assessed, we found the methodologies, modelled assumptions and data used within the allowance for ECL assessment to be appropriate and in line with the requirements of IFRS 9.
Payment Protection Insurance (PPI) **Group and Bank** *Refer to page 34 (Note 2: Accounting policies), page 40 (Note 3: Critical accounting judgements and estimates) and page 72 (Note 29: Other provisions).* Provisions reflecting the Group's best estimate of present obligations relating to anticipated customer redress payments, operational costs and regulatory costs as a result of PPI continues to be significant and therefore represent a key audit matter. Determining the measurement of provisions requires a number of assumptions which are made using a significant degree of management judgement. Key assumptions include the conversion ratio of PPI information requests to complaints, related redress costs and operational costs.	Our work focused on the valuation of conduct provisions relating to PPI policies. We understood and tested the key controls around the appropriateness of the model calculation. We found that these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit. The provision is based on assumptions determined using management judgement with reference to historic experience. We understood and challenged the provisioning methodologies and underlying assumptions, including whether historic information was an appropriate indicator of future experience. For example, we challenged management on how many complaints eligible for redress would arise from the information requests which had been received. We independently recalculated the provision and compared our results to management's model output. We performed sensitivity analysis on the assumptions used within the model to inform our risk assessment of which were significant. We performed sample testing over the data used to inform the key assumptions within the model. We considered regulatory developments and reviewed the Group's correspondence with the FCA and PRA, discussing the content of any correspondence considered to be pertinent to our audit with management. We also met with each regulator. Given the inherent uncertainty in the estimation of the PPI provision and its judgemental nature, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management around whether the disclosures were sufficiently clear in highlighting significant uncertainties and the sensitivity of the provision to changes in the underlying assumptions. Based on the procedures performed and evidence obtained, we found management's assumptions to be appropriate.

Key audit matter	How our audit addressed the key audit matter
Hedge accounting **Group and Bank** *Refer to page 34 (Note 2: Accounting policies) and page 105 (Note 43: Financial risk management).* The Group enters into derivative contracts in order to manage and economically hedge risks such as interest and foreign exchange rate risk. These arrangements create accounting mismatches which are addressed through designating instruments into fair value or cash flow hedge accounting relationships. The Group's application of hedge accounting, including determining effectiveness, is largely manual in nature, which increases the risk of errors and hence the risk that financial reporting is not compliant with IFRS requirements.	We understood and tested key controls over the designation and ongoing management of hedge accounting relationships, including testing of hedge effectiveness as well as the hedging strategy and related documentation prior to the implementation of new hedges. We found these key controls were designed, implemented and operated effectively, and therefore determined that we could place reliance on these key controls for the purposes of our audit. Our testing included the following: – Examining selected hedge documentation to assess whether it complies with the requirements of IFRS; – Testing the key year-end reconciliations between underlying source systems and the models used to manage hedging relationships; – Independently assessing whether management have captured and are monitoring all material sources of ineffectiveness, including any impact of reference rate reform; – Re-performing a sample of hedge effectiveness calculations; and – Testing a sample of manual adjustments posted to record ineffectiveness. Based on the evidence obtained, we determined the application of hedge accounting to be appropriate and compliant with the requirements of IFRS.
Privileged access to IT systems **Group and Bank** The Group's financial reporting processes are reliant on automated processes, controls and data managed by IT systems. For the purposes of our audit, we validate the design, implementation and operating effectiveness of those automated and IT dependent controls that support the in-scope financial statement line items. We also review the supporting IT General Computer Controls (ITGCs) that provide assurance over the effective operation of these controls as well as those controls that manage the integrity of relevant data repositories for the full financial reporting period. As part of our audit work in prior periods, we identified control matters in relation to the management of IT privileged access to IT platforms supporting applications in-scope for financial reporting. While there is an ongoing programme of activities to address such control matters across the IT estate, the fact that these were open during the period meant there was a risk that automated functionality, reports and data from the systems were not reliable.	We tested the design and operating effectiveness of those key controls identified that manage IT privileged access across the in-scope IT platforms. Specifically, we tested controls over: – The completeness and accuracy of the Access Controls Lists from IT platforms that are used by downstream IT security processes; – The onboarding and management of IT privileged accounts through the privileged access break-glass tool (including static IT privileged accounts); – The monitoring of security events on IT platforms by the Security Operations Centre; and – Approval, recertification and timely removal of access from IT systems. As part of our review, we identified a number of IT privileged accounts that had not been onboarded to the privileged access restriction tool during the period. Consequently, we performed an assessment of each of the areas within our audit approach where we place reliance on automated functionality and data within IT systems. In each case we identified a combination of mitigating controls, performed additional audit procedures and assessed other mitigating factors in order to respond to the impact on our overall audit approach.
Potential impact of Coronavirus **Group and Bank** *Refer to page 136 (Note 48: Events since the balance sheet date).* Since the balance sheet date there has been a global pandemic of Coronavirus which has also taken hold in the UK. This has been disruptive to financial markets and normal patterns of human behaviour. This is anticipated to translate into an adverse impact on the UK economy. The UK government and Bank of England have announced measures designed to ameliorate resulting adverse impacts on the UK economy. Management have specifically considered the impact on the financial statements, including its impact on the going concern assessment and post balance sheet event disclosures. The directors have concluded that the matter is a non-adjusting post balance sheet event, the financial effect of which cannot be reliably estimated at this stage.	We critically assessed management's conclusion that the matter be treated as a non-adjusting post balance sheet event and that the directors consider the impact of which cannot be reliably estimated at this stage. We considered: – The timing of the development of the outbreak across the world and in the UK; – The timing and nature of UK government advice to UK citizens; and – How the financial statements might be impacted by the aforementioned disruption and the complexity in measuring such impacts. In forming our conclusions over going concern, we evaluated whether management's going concern assessment considered impacts arising from Coronavirus. Our procedures in respect of going concern included: – Evaluating the appropriateness of the stress scenarios used and their impact on the Group's and Bank's capital and liquidity positions; and – Substantiating the Group's and Bank's access to unencumbered collateral placed with, and liquidity facilities available from, the Bank of England. Based on the work performed, we are satisfied that the matter has been appropriately evaluated and reflected in the financial statements.

How we tailored the audit scope
We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Bank, the accounting processes and controls, and the industry in which they operate.

The Group is structured into two segments being Retail and Commercial Banking. Each of the segments comprises a number of components. The consolidated financial statements are a consolidation of the components.

In establishing the overall approach to the Group audit, we determined the type of work that is required to be performed over the components by us, as the group engagement team, or auditors within PwC UK and from other PwC network firms operating under our instruction ('component auditors'). Almost all of our audit work is undertaken by PwC UK component auditors.

Where the work was performed by component auditors, we determined the level of involvement we needed to have in their audit work to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole. This included regular communication with the component auditors throughout the audit, the issuance of instructions, a review of the results of their work on significant and elevated risk areas and formal clearance meetings.

Any components which were considered individually financially significant in the context of the Group's consolidated financial statements (defined as components that represent more than or equal to 10% of the total assets of the consolidated Group) were considered full scope components. We considered the individual financial significance of other components in relation to primary statement account balances. We considered the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). Any component which was not already included as a full scope component but was identified as being individually financially significant in respect of one or more account balances was subject to specific audit procedures over those account balances. Inconsequential components (defined as components which, in our judgement, did not present a reasonable possibility of a risk of material misstatement either individually or in aggregate) were eliminated from further consideration for specific audit procedures although they were subject to Group level analytical review procedures. All remaining components which were neither inconsequential nor individually financially significant were subject to procedures which addressed the risk of material misstatement including testing of entity level controls, information technology general controls and Group and component level analytical review procedures.

Certain account balances were audited centrally by the group engagement team.

Components within the scope of our audit contributed 99 per cent of Group total assets and 88 per cent of Group total income.

Materiality
The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Bank financial statements
Overall materiality	£120 million (2018: £150 million).	£120 million (2018: £150 million).
How we determined it	5 per cent of adjusted profit before tax. Profit was adjusted to remove the effects of certain items which were considered to have a disproportionate impact.	1 per cent of total assets but limited to the overall Group materiality.
Rationale for benchmark applied	Our starting point was 5 per cent of profit before tax, a generally accepted auditing practice. Profit before tax was adjusted to remove the disproportionate effect of regulatory provisions as they are considered not to reflect the long term performance of the Group.	We have selected total assets as an appropriate benchmark for Bank materiality. Profit based benchmarks are not considered the most appropriate for Bank materiality as the Group is not required to disclose a Bank income statement. Where the calculated Bank materiality from total assets exceeds the Group overall materiality level, the Bank overall materiality has been restricted to equal the Group overall materiality level.

For each component in the scope of the Group audit, we allocated a materiality that is less than the overall Group materiality. The materiality allocated across components was £50 million. Certain components were audited to a local statutory audit materiality that was also less than the allocated materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £12 million (Group and Bank audit) (2018: £15 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern
ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's and Bank's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Bank's ability to continue as a going concern.

Reporting on other information
The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Independent auditors' report

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic report and Directors' report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 December 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and Bank and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report.

Responsibilities for the financial statements and the audit
Responsibilities of the directors for the financial statements
As explained more fully in the Statement of directors' responsibilities set out on page 16, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report
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.

Other required reporting

Companies Act 2006 exception reporting
Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Appointment
Following the recommendation of the Audit Committee, we were appointed by the members on 28 February 2009 to audit the financial statements for the year ended 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement is 11 years, covering the years ended 31 December 2009 to 31 December 2019. The audit was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation for the 2021 audit and we will cease to be auditor of the Group.

Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

23 March 2020

Consolidated income statement

for the year ended 31 December 2019

The Group	Note	2019 £ million	2018[1] £ million
Interest and similar income		**8,659**	8,696
Interest and similar expense		**(3,231)**	(3,013)
Net interest income	5	**5,428**	5,683
Fee and commission income		**601**	565
Fee and commission expense		**(281)**	(360)
Net fee and commission income	6	**320**	205
Net trading income	7	**245**	17
Other operating income	8	**40**	59
Other income		**605**	281
Total income		**6,033**	5,964
Regulatory provisions		**(1,217)**	(435)
Other operating expenses		**(3,088)**	(3,104)
Total operating expenses	9	**(4,305)**	(3,539)
Trading surplus		**1,728**	2,425
Impairment	11	**(450)**	(194)
Profit before tax		**1,278**	2,231
Tax expense	12	**(604)**	(663)
Profit for the year		**674**	1,568
Profit attributable to ordinary shareholders		**573**	1,467
Profit attributable to other equity holders		**101**	101
Profit attributable to equity holders		**674**	1,568
Profit attributable to non-controlling interests		**–**	–
Profit for the year		**674**	1,568

1 Restated, see note 1.

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

Statements of comprehensive income

for the year ended 31 December 2019

The Group	2019 £ million	2018[1] £ million
Profit for the year	**674**	1,568
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before tax	**23**	–
Tax	**(6)**	–
	17	–
Movement in revaluation reserve in respect of financial assets held at fair value through other comprehensive income – equity shares:		
Change in fair value	**–**	10
Tax	**–**	–
	–	10
Items that may subsequently be reclassified to profit or loss:		
Movement in revaluation reserve in respect of financial assets held at fair value through other comprehensive income – debt securities:		
Change in fair value	**5**	3
Income statement transfers in respect of disposals	**–**	(16)
Tax	**(1)**	1
	4	(12)
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**2**	(97)
Net income statement transfers	**37**	(28)
Tax	**(10)**	32
	29	(93)
Movements in foreign currency translation reserve:		
Currency translation differences (tax: £nil)	**(17)**	4
Transfers to income statement (tax: £nil)	**111**	–
	94	4
Other comprehensive income for the year, net of tax	**144**	(91)
Total comprehensive income for the year	**818**	1,477
Total comprehensive income attributable to ordinary shareholders	**717**	1,376
Total comprehensive income attributable to other equity holders	**101**	101
Total comprehensive income attributable to equity holders	**818**	1,477
Total comprehensive income attributable to non-controlling interests	**–**	–
Total comprehensive income for the year	**818**	1,477

1 Restated, see note 1.

The accompanying notes are an integral part of the financial statements

Statements of comprehensive income

for the year ended 31 December 2019

The Bank	2019 £ million	2018[1] £ million
Profit for the year	**749**	1,609
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements		
Remeasurements before tax	**23**	–
Tax	**(6)**	–
	17	–
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income – equity shares:		
Change in fair value	**–**	3
Tax	**–**	–
	–	3
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income – debt securities:		
Change in fair value	**5**	11
Income statement transfers in respect of disposals	**–**	(16)
Tax	**(1)**	3
	4	(2)
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**2**	(97)
Net income statement transfers	**37**	(28)
Tax	**(10)**	32
	29	(93)
Movements in foreign currency translation reserve:		
Currency translation differences (tax: £nil)	**(8)**	3
Transfers to income statement (tax: £nil)	**(123)**	–
	(131)	3
Other comprehensive income for the year, net of tax	**(81)**	(89)
Total comprehensive income for the year	**668**	1,520
Total comprehensive income attributable to ordinary shareholders	**567**	1,419
Total comprehensive income attributable to other equity holders	**101**	101
Total comprehensive income for the year	**668**	1,520

1 Restated, see note 1.

The accompanying notes are an integral part of the financial statements

Bank of Scotland plc

Balance sheets

at 31 December 2019

		The Group		The Bank	
	Note	**31 December 2019 £ million**	31 December 2018[1] £ million	**31 December 2019 £ million**	31 December 2018 £ million
Assets					
Cash and balances at central banks		**2,492**	2,579	**2,492**	2,579
Items in the course of collection from banks		**40**	181	**40**	181
Financial assets at fair value through profit or loss	13	**463**	509	**117**	110
Derivative financial instruments	14	**10,338**	9,361	**10,296**	9,225
Loans and advances to banks	15	**311**	471	**307**	471
Loans and advances to customers	15	**258,315**	262,324	**252,931**	256,990
Due from fellow Lloyds Banking Group undertakings	15	**97,534**	58,932	**108,935**	69,915
Financial assets at amortised cost		**356,160**	321,727	**362,173**	327,376
Financial assets at fair value through other comprehensive income	18	**2,253**	968	**2,253**	968
Goodwill	19	**325**	325	**325**	325
Other intangible assets	20	**138**	120	**138**	120
Property, plant and equipment	21	**1,407**	777	**1,374**	677
Current tax recoverable		**104**	7	**166**	78
Deferred tax assets	28	**1,652**	1,801	**1,647**	1,800
Retirement benefit assets		**46**	–	**46**	–
Investment in subsidiary undertakings	22	**–**	–	**74**	83
Other assets	23	**356**	393	**361**	404
Total assets		**375,774**	338,748	**381,502**	343,926

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

Balance sheets

at 31 December 2019

		The Group		The Bank	
Equity and liabilities	Note	**31 December 2019 £ million**	31 December 2018[1] £ million	**31 December 2019 £ million**	31 December 2018 £ million
Liabilities					
Deposits from banks		**16,472**	20,908	**16,472**	20,908
Customer deposits		**151,845**	162,141	**151,818**	162,141
Due to fellow Lloyds Banking Group undertakings		**161,618**	111,769	**169,813**	119,600
Items in course of transmission to banks		**143**	274	**143**	274
Financial liabilities at fair value through profit or loss	24	**47**	103	**–**	50
Derivative financial instruments	14	**11,352**	10,208	**11,048**	9,864
Notes in circulation		**1,079**	1,104	**1,079**	1,104
Debt securities in issue	25	**11,204**	11,861	**9,700**	10,184
Other liabilities	27	**1,831**	956	**1,679**	668
Current tax liabilities		**15**	2	**9**	–
Other provisions	29	**977**	1,027	**968**	1,006
Subordinated liabilities	30	**6,101**	6,775	**6,101**	6,775
Total liabilities		**362,684**	327,128	**368,830**	332,574
Equity					
Share capital	31	**5,847**	5,847	**5,847**	5,847
Other reserves	32	**2,019**	1,892	**2,047**	2,145
Retained profits[1]	33	**2,516**	2,373	**2,078**	1,860
Shareholders' equity		**10,382**	10,112	**9,972**	9,852
Other equity instruments	34	**2,700**	1,500	**2,700**	1,500
Total equity excluding non-controlling interests		**13,082**	11,612	**12,672**	11,352
Non-controlling interests		**8**	8	**–**	–
Total equity		**13,090**	11,620	**12,672**	11,352
Total equity and liabilities		**375,774**	338,748	**381,502**	343,926

1 The Bank recorded a profit after tax for the year of £749 million (2018: £1,609 million).

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

The directors approved the financial statements on 23 March 2020.

Lord Blackwell	**António Horta-Osório**	**William Chalmers**
Chairman	Chief Executive	Chief Financial Officer

Statements of changes in equity

for the year ended 31 December 2019

The Group	Attributable to equity shareholders				Other equity instruments £ million	Non-controlling interests £ million	Total £ million
	Share capital £ million	Other reserves £ million	Retained profits £ million	Total £ million			
Balance at 1 January 2018	5,847	1,989	3,827	11,663	1,500	8	13,171
Comprehensive income							
Profit for the year[1]	–	–	1,568	1,568	–	–	1,568
Other comprehensive income							
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	–	(12)	–	(12)	–	–	(12)
Movements in revaluation reserve in respect of equity shares held at fair value through other comprehensive income, net of tax	–	10	–	10	–	–	10
Movements in cash flow hedging reserve, net of tax	–	(93)	–	(93)	–	–	(93)
Currency translation differences, net of tax	–	4	–	4	–	–	4
Total other comprehensive income	–	(91)	–	(91)	–	–	(91)
Total comprehensive income	–	(91)	1,568	1,477	–	–	1,477
Transactions with owners							
Dividends (note 35)	–	–	(3,000)	(3,000)	–	–	(3,000)
Distributions on other equity instruments[1]	–	–	(101)	(101)	–	–	(101)
Capital contribution received	–	–	73	73	–	–	73
Total transactions with owners	–	–	(3,028)	(3,028)	–	–	(3,028)
Realised gains and losses on equity shares held at fair value through other comprehensive income	–	(6)	6	–	–	–	–
Balance at 31 December 2018	**5,847**	**1,892**	**2,373**	**10,112**	**1,500**	**8**	**11,620**
Comprehensive income							
Profit for the year	**–**	**–**	**674**	**674**	**–**	**–**	**674**
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax:	**–**	**–**	**17**	**17**	**–**	**–**	**17**
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	**–**	**4**	**–**	**4**	**–**	**–**	**4**
Movements in cash flow hedging reserve, net of tax	**–**	**29**	**–**	**29**	**–**	**–**	**29**
Currency translation differences, net of tax	**–**	**94**	**–**	**94**	**–**	**–**	**94**
Total other comprehensive income	**–**	**127**	**17**	**144**	**–**	**–**	**144**
Total comprehensive income	**–**	**127**	**691**	**818**	**–**	**–**	**818**
Transactions with owners							
Dividends (note 35)	**–**	**–**	**(500)**	**(500)**	**–**	**–**	**(500)**
Distributions on other equity instruments	**–**	**–**	**(101)**	**(101)**	**–**	**–**	**(101)**
Issue of other equity instruments	**–**	**–**	**–**	**–**	**1,200**	**–**	**1,200**
Capital contribution received	**–**	**–**	**53**	**53**	**–**	**–**	**53**
Total transactions with owners	**–**	**–**	**(548)**	**(548)**	**1,200**	**–**	**652**
Balance at 31 December 2019	**5,847**	**2,019**	**2,516**	**10,382**	**2,700**	**8**	**13,090**

1 Restated, see note 1.

Further details of movements in the Group's share capital and reserves are provided in notes 31, 32, 33 and 34.

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

Statements of changes in equity

for the year ended 31 December 2019

The Bank	Share capital £ million	Other reserves £ million	Retained profits £ million	Shareholder equity £ million	Other equity instruments £ million	Total £ million
Balance at 1 January 2018	5,847	2,240	3,273	11,360	1,500	12,860
Comprehensive income						
Profit for the year[1]	–	–	1,609	1,609	–	1,609
Other comprehensive income						
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	–	(2)	–	(2)	–	(2)
Movements in revaluation reserve in respect of equity shares held at fair value through other comprehensive income, net of tax	–	3	–	3	–	3
Movements in cash flow hedging reserve, net of tax	–	(93)	–	(93)	–	(93)
Currency translation differences, net of tax	–	3	–	3	–	3
Total other comprehensive income	–	(89)	–	(89)	–	(89)
Total comprehensive income	–	(89)	1,609	1,520	–	1,520
Transactions with owners						
Dividends (note 35)	–	–	(3,000)	(3,000)	–	(3,000)
Distributions on other equity instruments[1]	–	–	(101)	(101)	–	(101)
Capital contribution received	–	–	73	73	–	73
Total transactions with owners	–	–	(3,028)	(3,028)	–	(3,028)
Realised gains and losses on equity shares held at fair value through other comprehensive income	–	(6)	6	–	–	–
Balance at 31 December 2018	**5,847**	**2,145**	**1,860**	**9,852**	**1,500**	**11,352**
Comprehensive income						
Profit for the year	**–**	**–**	**749**	**749**	**–**	**749**
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax:	**–**	**–**	**17**	**17**	**–**	**17**
Movements in revalutation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	**–**	**4**	**–**	**4**	**–**	**4**
Movements in cash flow hedging reserve, net of tax	**–**	**29**	**–**	**29**	**–**	**29**
Currency translation differences, net of tax	**–**	**(131)**	**–**	**(131)**	**–**	**(131)**
Total other comprehensive income	**–**	**(98)**	**17**	**(81)**	**–**	**(81)**
Total comprehensive income	**–**	**(98)**	**766**	**668**	**–**	**668**
Transactions with owners						
Dividends (note 35)	**–**	**–**	**(500)**	**(500)**	**–**	**(500)**
Distributions on other equity instruments	**–**	**–**	**(101)**	**(101)**	**–**	**(101)**
Issue of other equity instruments	**–**	**–**	**–**	**–**	**1,200**	**1,200**
Capital contribution received	**–**	**–**	**53**	**53**	**–**	**53**
Total transactions with owners	**–**	**–**	**(548)**	**(548)**	**1,200**	**652**
Balance at 31 December 2019	**5,847**	**2,047**	**2,078**	**9,972**	**2,700**	**12,672**

1 Restated, see note 1.

Further details of movements in the Bank's share capital and reserves are provided in notes 31, 32, 33 and 34.

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

Cash flow statements

for the year ended 31 December 2019

	Note	The Group		The Bank	
		2019 £ million	2018 £ million	**2019 £ million**	2018 £ million
Profit before tax		**1,278**	2,231	**1,329**	2,212
Adjustments for:					
Change in operating assets	45(a)	**(35,720)**	29,712	**(36,375)**	31,105
Change in operating liabilities	45(b)	**35,483**	(27,737)	**36,169**	(29,194)
Non-cash and other items	45(c)	**803**	(1,007)	**651**	(1,152)
Tax paid		**(554)**	(975)	**(523)**	(870)
Net cash provided by (used in) operating activities		**1,290**	2,224	**1,251**	2,101
Cash flows from investing activities					
Purchase of financial assets		**(1,360)**	(550)	**(1,360)**	(550)
Proceeds from sale and maturity of financial assets		**184**	529	**184**	529
Dividends received from subsidiaries		**–**	–	**83**	126
Purchase of fixed assets		**(233)**	(178)	**(220)**	(123)
Proceeds from sale of fixed assets		**67**	74	**6**	31
Acquisition of businesses, net of cash acquired		**–**	–	**–**	(16)
Disposal of businesses, net of cash disposed	45(e)	**–**	47	**–**	47
Net cash (used in) provided by investing activities		**(1,342)**	(78)	**(1,307)**	44
Cash flows from financing activities					
Dividends paid to ordinary shareholders	35	**(500)**	(3,000)	**(500)**	(3,000)
Distributions on other equity instruments		**(101)**	(101)	**(101)**	(101)
Interest paid on subordinated liabilities		**(210)**	(223)	**(210)**	(222)
Proceeds from issue of other equity instruments		**1,200**	–	**1,200**	–
Repayment of subordinated liabilities	30	**(578)**	(194)	**(578)**	(194)
Net cash used in financing activities		**(189)**	(3,518)	**(189)**	(3,517)
Effects of exchange rate changes on cash and cash equivalents		**(3)**	–	**(3)**	–
Change in cash and cash equivalents		**(244)**	(1,372)	**(248)**	(1,372)
Cash and cash equivalents at beginning of year		**1,003**	2,375	**1,003**	2,375
Cash and cash equivalents at end of year	45(d)	**759**	1,003	**755**	1,003

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

Notes to the accounts

1 Basis of preparation

The financial statements of Bank of Scotland 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 IFRS Interpretations Committee (IFRS IC) and its predecessor body. On adoption of IFRS 9 in 2018 the Group elected to continue applying hedge accounting under IAS 39. 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, financial assets measured at fair value through other comprehensive income, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

To improve transparency and ease of reference, the capital resources disclosure required under IFRS has been included within the Strategic Report on page 3. This disclosure is covered by the Audit opinion (included on pages 19 to 25) and referenced as audited.

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 Funding and liquidity on page 11 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 financial statements.

The Group adopted IFRS 16 *Leases* from 1 January 2019. IFRS 16 replaces IAS 17 *Leases* and addresses the classification and measurement of all leases. The Group's accounting as a lessor under IFRS 16 is substantially unchanged from its approach under IAS 17; however for lessee accounting there is no longer a distinction between the accounting for finance and operating leases. For all assets the lessee recognises a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use. Assets and liabilities arising from a lease are initially measured on a present value basis. The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the lessee's incremental borrowing rate. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. Payments associated with leases with a lease term of 12 months or less and leases of low-value assets are recognised as an expense in profit or loss on a straight-line basis. The Group elected to apply the standard retrospectively with the cumulative effect of initial application being recognised at 1 January 2019, comparatives have therefore not been restated. There was no impact on shareholders' equity. Further details of the impact of adoption of IFRS 16 are provided in note 46.

The Group has also implemented the amendments to IAS 12 *Income Taxes* with effect from 1 January 2019 and as a result tax relief on distributions on other equity instruments, previously taken directly to retained profits, is reported within tax expense in the income statement. Comparatives have been restated. Adoption of these amendments to IAS 12 has resulted in a reduction in tax expense and an increase in profit for the year in the 2019 of £27 million (2018: £27 million) for the Group and the Bank. There is no impact on shareholders' equity or on earnings per share.

The Group has early adopted the hedge accounting amendments *Interest Rate Benchmark Reform*, issued by the IASB as a response to issues arising from the planned replacement of interest rate benchmarks in a number of jurisdictions. The amendments confirm that entities applying hedge accounting can continue to assume that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of the uncertainties of the interest rate benchmark reform. Comparatives have not been restated. Further details are provided in note 43.

Certain balances due to and from fellow Lloyds Banking Group undertakings previously reported net are presented on a gross basis as at 31 December 2019. The Group does not intend to settle these balances on a net basis going forward.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2019 and which have not been applied in preparing these financial statements are given in note 47.

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2 Accounting policies

The accounting policies are set out below. These accounting policies have been applied consistently.

a Consolidation

The assets, liabilities and results of Group undertakings (including structured 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. Details of the Group's subsidiaries and related undertakings are given on pages 137 to 138.

(1) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through the exercise of its power. This generally accompanies a shareholding of more than one half of the voting rights although in certain circumstances a holding of less than one half of the voting rights may still result in the ability of the Group to exercise control. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to any of the above elements. 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.

Structured entities are entities that are designed so that their activities are not governed by way of voting rights. In assessing whether the Group has power over such entities in which it has an interest, the Group considers factors such as the purpose and design of the entity; its practical ability to direct the relevant activities of the entity; the nature of the relationship with the entity; and the size of its exposure to the variability of returns of the entity.

2 Accounting policies (continued)

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 2o). 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 joint arrangements over which the Group has joint control with other parties and has rights to the net assets of the arrangements. Joint control is the contractually agreed sharing of control of an arrangement and only exists when decisions about the relevant activities require the unanimous consent of the parties sharing control. 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 but is not control or joint control of those policies and is generally 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.

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

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. 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.

c Other intangible assets
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: up to 7 years for capitalised software; 10 to 15 years for brands and other intangibles.

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

d Revenue recognition
(1) Net interest income
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest method, except for those classified at fair value through profit or loss. 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 to the gross carrying amount of the financial asset (before adjusting for expected credit losses) or to the amortised cost of the financial liability, including 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. Interest income from non-credit impaired financial assets is recognised by applying the effective interest rate to the gross carrying amount of the asset; for credit impaired financial assets, the effective interest rate is applied to the net carrying amount after deducting the allowance for expected credit losses. Impairment policies are set out in (h) below.

(2) Fee and commission income and expense
Fees and commissions receivable which are not an integral part of the effective interest rate are recognised as income as the Group fulfils its performance obligations. The Group's principal performance obligations arising from contracts with customers are in respect of value added current accounts, credit cards and debit cards. These fees are received, and the Group's provides the service, monthly; the fees are recognised in income on this basis. The Group also receives certain fees in respect of its asset finance business where the performance obligations are typically fulfilled towards the end of the customer contract; these fees are recognised in income on this basis. Where it is unlikely that the loan commitments will be drawn, loan commitment fees are recognised in fee and commission income over the life of the facility, rather than as an adjustment to the effective interest rate for loans expected to be drawn. Incremental costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

(3) Other
Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to trading income are set out in e(3) below, those relating to leases are set out in (j)(1) below.

e Financial assets and liabilities
On initial recognition, financial assets are classified as measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the Group's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest.

2 Accounting policies (continued)

The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets when and only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Group's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare. Equity investments are measured at fair value through profit or loss unless the Group elects at initial recognition to account for the instruments at fair value through other comprehensive income. For these instruments, principally strategic investments, dividends are recognised in profit or loss but fair value gains and losses are not subsequently reclassified to profit or loss following derecognition of the investment.

The Group initially recognises loans and advances, deposits, debt securities in issue and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way 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 the obligation is discharged, cancelled or expires.

(1) Financial instruments measured at amortised cost
Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest. Financial assets measured at amortised cost are predominantly loans and advances to customers and banks together with certain debt securities used by the Group to manage its liquidity. Loans and advances are initially recognised when cash is advanced to the borrower at fair value inclusive of transaction costs. Interest income is accounted for using the effective interest method (see (d) above).

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.

(2) Financial assets measured at fair value through other comprehensive income
Financial assets that are held to collect contractual cash flows and for subsequent sale, where the assets' cash flows represent solely payments of principal and interest, are recognised in the balance sheet at their fair value, inclusive of transaction costs. Interest calculated using the effective interest method and foreign exchange gains and losses on assets denominated in foreign currencies are recognised in the income statement. All other gains and losses arising from changes in fair value are recognised directly in other comprehensive income, until the financial asset is either sold or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement other than in respect of equity shares, for which the cumulative revaluation amount is transferred directly to retained profits. The Group recognises a charge for expected credit losses in the income statement (see (h) below). As the asset is measured at fair value, the charge does not adjust the carrying value of the asset, it is reflected in other comprehensive income.

(3) Financial instruments measured at fair value through profit or loss
Financial assets are classified at fair value through profit or loss where they do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income or where they are designated at fair value through profit or loss to reduce an accounting mismatch. All derivatives are carried at fair value through profit or loss.

Trading securities, which 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, do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income and are measured at fair value through profit or loss. Financial assets measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses together with interest coupons and dividend income are recognised in the income statement within net trading income.

Financial liabilities are measured at fair value through profit or loss where they are trading liabilities or where they are designated at fair value through profit or loss in order to reduce an accounting mismatch; where the liabilities are part of a group of liabilities (or assets and liabilities) which is managed, and its performance evaluated, on a fair value basis; or where the 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. Financial liabilities measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses are recognised in the income statement within net trading income in the period in which they occur, except that gains and losses attributable to changes in own credit risk are recognised in other comprehensive income.

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. The fair values of derivative financial instruments are adjusted where appropriate to reflect credit risk (via credit valuation adjustments (CVAs), debit valuation adjustments (DVAs) and funding valuation adjustments (FVAs)), market liquidity and other risks.

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

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense. Securities which carry a discretionary coupon and have no fixed maturity or redemption date are classified as other equity instruments. Interest payments on these securities are recognised, net of tax, as distributions from equity in the period in which they are paid. 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 carrying value of the liability and the fair value of the new equity is recognised in profit or loss.

2 Accounting policies (continued)

(5) Sale and repurchase agreements (including securities lending and borrowing)
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 advances measured at amortised cost 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 borrowing and lending transactions are typically secured; collateral takes the form of securities or cash advanced or received. Securities lent to counterparties are retained on the balance sheet. Securities borrowed are not recognised on the balance sheet, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability. Cash collateral given or received is treated as a loan and advance measured at amortised cost or customer deposit.

f Derivative financial instruments and hedge accounting
As permitted by IFRS 9, the Group continues to apply the requirements of IAS 39 to its hedging relationships. All derivatives are recognised at their fair value. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 40(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

Changes in the fair value of all derivative instruments, other than those in effective cash flow and net investment hedging relationships, are recognised immediately in the income statement. As noted in (2) and (3) below, the change in fair value of a derivative in an effective cash flow or net investment hedging relationship is allocated between the income statement and other comprehensive income.

Derivatives embedded in a financial asset are not considered separately; the financial asset is considered in its entirety when determining whether its cash flows are solely payments of principal and interest. Derivatives embedded in financial liabilities 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.

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, 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. Note 14 provides details of the types of derivatives held by the Group and presents separately those designated in hedge relationships. In respect of interest rate benchmark reform, the Group assumes that the interest rate benchmark on which the hedged cash flows and/or the hedged risk are based, or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform. The Group does not discontinue a hedging relationship during the period of uncertainty arising from the interest rate benchmark reform solely because the actual results of the hedge are not highly effective.

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

(3) Net investment hedges
Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income, the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of. The hedging instrument 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. Cash collateral on exchange traded derivative transactions is presented gross unless the collateral cash flows are always settled net with the derivative cash flows. 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
The impairment charge in the income statement includes the change in expected credit losses and certain fraud costs. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. Expected credit losses are calculated as an unbiased and probability-weighted estimate using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held, repayments, or other mitigants of loss and including the impact of discounting using the effective interest rate.

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk since origination, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime

2 Accounting policies (continued)

expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk since initial recognition are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3. Some Stage 3 assets, mainly corporate, are subject to individual rather than collective assessment. Such cases are subject to a risk-based impairment sanctioning process, and these are reviewed and updated at least quarterly, or more frequently if there is a significant change in the credit profile.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Group uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings together with qualitative indicators such as watchlists and other indicators of historical delinquency, credit weakness or financial difficulty. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. Default is considered to have occurred when there is evidence that the customer is experiencing financial difficulty which is likely to affect significantly the ability to repay the amount due. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Group uses this 90 day backstop for all its products except for UK mortgages. For UK mortgages, the Group uses a backstop of 180 days past due as mortgage exposures more than 90 days past due, but less than 180 days, typically show high cure rates and this aligns with the Group's risk management practices.

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. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until the credit risk has improved such that it no longer represents a significant increase since origination (for a return to Stage 1), or the loan is no longer credit impaired (for a return to Stage 2). Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value.

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 continuing attempts to recover are no longer appropriate. For commercial 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.

i Property, plant and equipment

Property, plant and equipment (other than investment property) is 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: the shorter of 50 years and the remaining period of the lease for freehold/long and short leasehold premises; the shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease for leasehold improvements; 10 to 20 years for fixtures and furnishings; and 2 to 8 years for other equipment and motor vehicles.

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.

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital accretion or both. In accordance with the guidance published by the Royal Institution of Chartered Surveyors, investment property is carried at fair value based on current prices for similar properties, adjusted for the specific characteristics of the property (such as location or condition). If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices in less active markets. These valuations are reviewed at least annually by independent professionally qualified valuers. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be valued at fair value.

j Leases

Under IFRS 16, a lessor is required to determine whether a lease is a finance or operating lease. A lessee is not required to make this determination.

(1) 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 allowances for expected credit losses, 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 property, plant and equipment 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) As lessee

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Assets and liabilities arising from a lease are initially measured on a present value basis. The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the Group's incremental borrowing rate appropriate for the right of use asset arising from the lease.

2 Accounting policies (continued)

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit

k Employee benefits
Short-term employee benefits, such as salaries, paid absences, performance-based cash awards and social security costs are recognised over the period in which the employees provide the related services.

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 with a corresponding increase in equity. 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 or a Monte Carlo simulation. 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, together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement.

l Taxation
Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it. The tax consequences of the Group's dividend payments (including distributions on other equity instruments), if any, are charged or credited to the statement in which the profit distributed originally arose.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or another tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

m 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'). 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 non-monetary financial assets measured at fair value through other comprehensive income, 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; and 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 accounting policy 2f(3)). On disposal or liquidation 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 or liquidation.

2 Accounting policies (continued)

n 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.

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.

Provision is made for expected credit losses in respect of irrevocable undrawn loan commitments and financial guarantee contracts (see (h) above).

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

p 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.

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

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3 Critical accounting judgements and estimates

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 expected credit losses
The Group recognises an allowance for expected credit losses for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income and certain loan commitment and financial guarantee contracts. At 31 December 2019 the Group's expected loss allowance was £2,148 million (31 December 2018: £2,189 million), of which £2,093 million (31 December 2018: £2,139 million) was in respect of drawn balances; and the Bank's expected credit loss allowance was £2,108 million (31 December 2018: £1,989 million), of which £2,053 million (31 December 2018: £1,939 million) was in respect of drawn balances.

The calculation of the Group's expected credit loss (ECL) allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Group to make a number of judgements, assumptions and estimates. The most significant are set out below.

Definition of default
The probability of default (PD) of an exposure, both over a 12 month period and over its lifetime, is a key input to the measurement of the ECL allowance. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The definition of default adopted by the Group is described in note 2(h) Impairment of financial assets. The Group has rebutted the presumption in IFRS 9 that default occurs no later than when a payment is 90 days past due for UK mortgages. As a result, at 31 December 2019, approximately £1.2 billion of UK mortgages were classified as Stage 2 rather than Stage 3 (31 December 2018: £1.4 billion); the impact on the Group's ECL allowance was not material.

Lifetime of an exposure
The PD of a financial asset is dependent on its expected life. A range of approaches, segmented by product type, has been adopted by the Group to estimate a product's expected life. These include using the full contractual life and taking into account behavioural factors such as early repayments and refinancing. For non-revolving retail assets, the Group has assumed the expected life for each product to be the time taken for all significant losses to be observed. For retail revolving products, the Group has considered the losses beyond the contractual term over which the Group is exposed to credit risk. For commercial overdraft facilities, the average behavioural life has been used. Changes to the assumed expected lives of the Group's assets could impact the ECL allowance recognised by the Group.

Significant increase in credit risk
Performing assets are classified as either Stage 1 or Stage 2. An ECL allowance equivalent to 12 months expected losses is established against assets in Stage 1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk (SICR) since initial recognition.

The Group uses a quantitative test together with qualitative indicators to determine whether there has been a SICR for an asset. For retail, a deterioration in the Retail Master Scale of four grades for credit cards, personal loans or overdrafts, three grades for personal mortgages, or two grades for UK motor finance accounts is treated as a SICR. For Commercial a doubling of PD with a minimum increase in PD of 1 per cent and a resulting change in the underlying grade is treated as a SICR. All financial assets are assumed to have suffered a SICR if they are more than 30 days past due.

The setting of precise trigger points combined with risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance. The Group monitors the effectiveness of SICR criteria on an ongoing basis.

Post-model adjustments
Limitations in the Group's impairment models or input data may be identified through the on-going assessment and validation of the output of the models. In these circumstances, management make appropriate adjustments to the Group's allowance for impairment losses to ensure the overall provision adequately

3 Critical accounting judgements and estimates (continued)

reflects all material risks. These adjustments are generally determined taking into account the particular attributes of the exposure which have not been adequately captured by the primary impairment models.

Forward looking information
The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. In order to do this, the Group has developed an economic model to project a wide range of key impairment drivers using information derived mainly from external sources. These drivers include factors such as the unemployment rate, the house price index, commercial property prices and corporate credit spreads. The model-generated economic scenarios for the six years beyond 2019 are mapped to industry-wide historical loss data by portfolio. Combined losses across portfolios are used to rank the scenarios by severity of loss. Alongside a defined central scenario three further scenarios are generated by averaging a group of individual scenarios around specified points along the loss distribution to reflect the range of outcomes. The central scenario reflects the Group's base case assumptions used for medium-term planning purposes, an upside and a downside scenario are also produced together with a severe downside scenario. Rare occurrences of adverse economic events can lead to relatively large credit losses which means that typically the most likely outcome is less than the probability-weighted outcome of the range of possible future events. To allow for this a relatively unlikely severe downside scenario is therefore included. At 31 December 2018 and 2019, the base case, upside and downside scenarios each carry a 30 per cent weighting; the severe downside scenario is weighted at 10 per cent. The choice of alternative scenarios and scenario weights is a combination of quantitative analysis and judgemental assessment to ensure that the full range of possible outcomes and material non-linearity of losses are captured. A committee under the chairmanship of the Chief Economist meets quarterly, to review and, if appropriate, recommend changes to the economic scenarios to the Chief Financial Officer and Chief Risk Officer. Findings dealing with all aspects of the expected credit loss calculation are presented to the Group Audit Committee.

For each major product grouping models have been developed which utilise historical credit loss data to produce PDs for each scenario; an overall weighted average PD is used to assist in determining the staging of financial assets and related ECL.

The key UK economic assumptions made by the Group as at 31 December 2019 averaged over a five-year period are shown below:

	At 31 December 2019				At 31 December 2018			
Economic assumptions	**Base Case %**	**Upside %**	**Downside %**	**Severe downside %**	Base Case %	Upside %	Downside %	Severe downside %
At 31 December 2019								
Interest rate	**1.25**	**2.04**	**0.49**	**0.11**	1.25	2.34	1.30	0.71
Unemployment rate	**4.3**	**3.9**	**5.8**	**7.2**	4.5	3.9	5.3	6.9
House price growth	**1.3**	**5.0**	**(2.6)**	**(7.1)**	2.5	6.1	(4.8)	(7.5)
Commercial real estate price growth	**(0.2)**	**1.8**	**(3.8)**	**(7.1)**	0.4	5.3	(4.7)	(6.4)

The Group's base-case economic scenario has changed little over the year and reflects a broadly stable outlook for the economy. Although there remains considerable uncertainty about the economic consequences of the UK's exit from the European Union, the Group considers that at this stage the range of possible economic outcomes is adequately reflected in its choice and weighting of scenarios. The averages shown above do not fully reflect the peak to trough changes in the stated assumptions over the period. The tables below illustrate the variability of the assumptions from the start of the scenario period to the peak and trough.

	At 31 December 2019				At 31 December 2018			
Economic assumptions – start to peak	**Base Case %**	**Upside %**	**Downside %**	**Severe Downside %**	Base Case %	Upside %	Downside %	Severe Downside %
At 31 December 2019								
Interest rate	**1.75**	**2.56**	**0.75**	**0.75**	1.75	4.00	1.75	1.25
Unemployment rate	**4.6**	**4.6**	**6.9**	**8.3**	4.8	4.3	6.3	8.6
House price growth	**6.0**	**26.3**	**(1.9)**	**(2.3)**	13.7	34.9	0.6	(1.6)
Commercial real estate price growth	**0.1**	**10.4**	**(0.6)**	**(1.1)**	0.1	26.9	(0.5)	(0.5)

	At 31 December 2019				At 31 December 2018			
Economic assumptions – start to trough	**Base Case %**	**Upside %**	**Downside %**	**Severe Downside %**	Base Case %	Upside %	Downside %	Severe Downside %
At 31 December 2019								
Interest rate	**0.75**	**0.75**	**0.35**	**0.01**	0.75	0.75	0.75	0.25
Unemployment rate	**3.8**	**3.4**	**3.9**	**3.9**	4.1	3.5	4.3	4.2
House price growth	**(1.9)**	**(0.8)**	**(14.8)**	**(33.1)**	0.4	2.3	(26.5)	(33.5)
Commercial real estate price growth	**(0.9)**	**0.3**	**17.5**	**(30.9)**	(0.1)	0.0	(23.8)	(33.8)

The table below shows the Group's ECL for the upside and downside scenarios using a 100 per cent weighting, with stage allocation based on each specific scenario.

3 Critical accounting judgements and estimates (continued)

	At 31 December 2019	
	Upside £m	**Downside £m**
ECL allowance	**1,820**	**2,262**

Recoverability of deferred tax assets
At 31 December 2019 the Group carried deferred tax assets on its balance sheet of £1,652 million (2018: £1,801 million) and the Bank carried deferred tax assets of £1,647 million (2018: £1,800 million) principally relating to tax losses carried forward. Further information on the Group's deferred tax assets and uncertain tax positions is provided in notes 28 and 38 respectively.

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised.

The Group has recognised a deferred tax asset of £1,402 million (2018: £1,498 million), and the Bank £1,382 million (2018: £1,478 million), in respect of UK trading losses carried forward. Substantially all of these losses have arisen in Bank of Scotland plc and they will be utilised as taxable profits arise in those legal entities in future periods.

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 Board-approved operating plan and the expected future economic outlook as set out in the strategic report, as well as the risks associated with future regulatory change.

Under current law there is no expiry date for UK trading losses not yet utilised, although (since Finance Act 2016) banking losses that arose before 1 April 2015 can only be used against 25 per cent of taxable profits arising after 1 April 2016, and they cannot be used to reduce the surcharge on banking profits. This restriction in utilisation means that the value of the deferred tax asset is only expected to be fully recovered by 2033. It is possible that future tax law changes could materially affect the value of these losses ultimately realised by the Group.

As disclosed in note 28, deferred tax assets totalling £137 million (2018: £139 million) for the Group and £101 million (2018: £100 million) for the Bank have not been recognised in respect of certain capital and trading losses carried forward, unrelieved foreign tax credits and other tax deductions, as there are currently no expected future taxable profits against which these assets can be utilised.

Regulatory provisions
At 31 December 2019, the Group carried provisions of £828 million (2018: £834 million) and the Bank £819 million (2018: £816 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches.

Determining the amount of the provisions, which represent management's best estimate of the cost of settling these issues, requires the exercise of significant judgement and estimate. It will often be necessary to form a view on matters which are inherently uncertain, such as the scope of reviews required by regulators, and to estimate the number of future complaints, the extent to which they will be upheld, the average cost of redress and the impact of legal decisions that may be relevant to claims received. Consequently the continued appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and other relevant evidence and adjustments made to the provisions where appropriate.

More detail on the nature of the assumptions that have been made and key sensitivities is set out in note 29.

Fair value of financial instruments
At 31 December 2019, the carrying value of the Group's financial instrument assets held at fair value was £13,054 million (2018: £10,838 million), and its financial instrument liabilities held at fair value was £11,399 million (2018: £10,311 million). Included within these balances are derivative assets of £10,338 million (2018: £9,361 million) and derivative liabilities of £11,352 million (2018: £10,208 million). The carrying value of the Bank's financial instrument assets held at fair value was £12,666 million (2018: £10,303 million) and financial liabilities was £11,048 million (2018: £9,914 million) including derivative assets of £10,296 million (2018: £9,225 million) and derivative liabilities of £11,048 million (2018: £9,864 million). The Group's accounting policy for its financial instruments is set out in note 2(e) and 2(f).

In accordance with IFRS 13 Fair Value Measurement, 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 minimal estimates are made in determining fair value. 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.

The valuation techniques for level 2 and level 3 financial instruments involve management judgement and estimates the extent of which depends on the complexity of the instrument and the availability of market observable information. In addition, in line with market practice, the Group applies credit, debit and funding valuation adjustments in determining the fair value of its uncollateralised derivative positions. A description of these adjustments is set out in note 40. 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 also set out in note 40.

4 Segmental analysis

IFRS 8 'Operating Segments' requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. The chief operating decision maker has been identified as the Group Executive Committee of Lloyds Banking Group. The Bank of Scotland Group is managed on an entity basis and not by segment. The Group Executive Committee does not assess the Bank of Scotland Group's performance and allocate resources across any segments, accordingly no segmental information is provided. A brief overview of the Group's sources of income is provided in the Business review. The ultimate parent undertaking, Lloyds Banking Group plc, produces consolidated accounts which set out the basis of the segments through which it manages performance and allocates resources across the consolidated Lloyds Banking Group.

Following the reduction in the Group's non-UK activities, an analysis between UK and non-UK activities is no longer provided.

5 Net interest income

The Group	Weighted average effective interest rate 2019 %	Weighted average effective interest rate 2018 %	2019 £m	2018 £m
Interest and similar income:				
Financial assets held at amortised cost	**2.53**	2.68	**8,633**	8,681
Financial assets at fair value through other comprehensive income	**1.34**	1.60	**26**	15
Total interest and similar income[1]	**2.52**	2.67	**8,659**	8,696
Interest and similar expense:				
Deposits from banks, customer deposits and other liabilities	**1.03**	1.08	**(2,998)**	(2,956)
Debt securities in issue[2]	**0.31**	(1.28)	**(34)**	142
Subordinated liabilities	**2.84**	2.91	**(181)**	(199)
Lease liabilities	**2.48**	–	**(18)**	–
Total interest and similar expense	**1.04**	1.03	**(3,231)**	(3,013)
Net interest income			**5,428**	5,683

1 Includes £12 million (2018: £7 million) in respect of interest income on finance leases.

2 The impact of the Group's hedging arrangements is included on this line; excluding this impact the weighted average effective interest rate in respect of debt securities in issue would be 2.97 per cent (2018: 3.01 per cent).

Included within interest and similar income is £129 million (2018: £142 million) in respect of credit-impaired financial assets. Net interest income also includes a debit of £37 million (2018: credit of £28 million) transferred from the cash flow hedging reserve (see note 32).

6 Net fee and commission income

The Group	2019 £m	2018 £m
Fee and commission income:		
Current accounts	**214**	201
Credit and debit card fees	**249**	238
Corporate banking and treasury fees	**13**	13
Other fees and commissions	**125**	113
Total fee and commission income	**601**	565
Fee and commission expense	**(281)**	(360)
Net fee and commission income	**320**	205

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.

At 31 December 2019, the Group held on its balance sheet £34 million (31 December 2018: £16 million) in respect of services provided to customers. There were no unsatisfied performance obligations at 31 December 2018 or 31 December 2019.

The most significant performance obligations undertaken by the Group are in respect of current accounts, the provision of other banking services for commercial customers and credit and debit card services. In respect of current accounts, the Group receives fees for the provision of bank account and transaction services such as ATM services, fund transfers, overdraft facilities and other value-added offerings. For commercial customers, alongside its provision of current accounts, the Group provides other corporate banking services including factoring and commitments to provide loan financing. Loan commitment fees are included in fees and commissions where the loan is not expected to be drawn down by the customer. The Group receives interchange and merchant fees, together with fees for overseas use and cash advances, for provision of card services to cardholders and merchants.

7 Net trading income

The Group	2019 £m	2018 £m
Foreign exchange translation (losses) gains	**(29)**	(4)
Gains on foreign exchange trading transactions	**36**	38
Total foreign exchange	**7**	34
Investment property losses	**(8)**	–
Securities and other gains (losses) (see below)	**246**	(17)
Net trading income	**245**	17

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

	2019 £m	2018 £m
Net income arising on assets and liabilities mandatorily held at fair value through profit or loss:		
Financial instruments held for trading, including derivatives	**247**	(27)
Other	**(1)**	10
Securities and other gains	**246**	(17)

8 Other operating income

The Group	2019 £m	2018 £m
Operating lease rental income	**1**	4
Gains less losses on disposal of financial assets at fair value through other comprehensive income	**–**	16
Other	**39**	39
Total other operating income	**40**	59

9 Operating expenses

The Group	2019 £m	2018 £m
Staff costs:		
Salaries	**1,039**	1,116
Social security costs	**96**	110
Pensions and other post-retirement benefit schemes	**208**	267
	1,343	1,493
Premises and equipment:		
Rent and rates	**54**	162
Repairs and maintenance	**58**	63
Other	**96**	77
	208	302
Other expenses:		
Communications and data processing	**121**	115
Advertising and promotion	**51**	41
Professional fees	**15**	8
Other	**1,115**	983
	1,302	1,147
Depreciation and amortisation:		
Depreciation of property, plant and equipment (note 21)	**204**	126
Amortisation of other intangible assets (note 20)	**31**	36
	235	162
Total operating expenses, excluding regulatory provisions	**3,088**	3,104
Regulatory provisions:		
Payment protection insurance provision (note 29)	**963**	185
Other regulatory provisions (note 29)	**254**	250
	1,217	435
Total operating expenses	**4,305**	3,539

The average number of staff on a headcount basis during the year was as follows[1]:

	2019	2018
UK	**28,860**	31,121
Overseas	**378**	382
Total	**29,238**	31,503

1 The majority of the Group's staff are contractually employed by the Bank's parent company, HBOS plc.

10 Auditor's remuneration

Fees payable to the Bank's auditors
During the year the auditors earned the following fees:

	2019 £m	2018 £m
Fees payable for the audit of the Bank's current year annual report	**3.2**	2.4
Fees payable for other services:		
Audit of the Bank's subsidiaries pursuant to legislation	**0.6**	0.5
Other services supplied pursuant to legislation	**0.3**	0.3
Total fees payable to the Bank's auditors by the Group	**4.1**	3.2

The following types of services are included in the categories listed above:

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings. Other services supplied pursuant to legislation relate primarily to costs incurred in connection with client asset assurance with the Sarbanes-Oxley Act requirements associated with the audit of the financial statements of Lloyds Banking Group filed on Form 20-F.

10 Auditor's remuneration (continued)

Audit-related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements, for example acting as reporting accountants in respect of debt prospectuses required by the listing rules.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance and advisory services. The auditors are not engaged to provide tax services.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants.

Lloyds Banking Group has procedures that are designed to ensure auditor independence for Lloyds Banking Group plc and all of its subsidiaries, including prohibiting certain non-audit services. All audit work and non-audit assignments must be pre-approved by the Lloyds Banking Group audit committee (the Audit Committee) on an individual engagement basis; for certain types of non-audit engagements where the fee is 'de minimis' the Audit Committee has pre-approved all assignments subject to confirmation by management. On a quarterly basis, the Audit Committee receives and reviews a report detailing all pre-approved services and amounts paid to the auditors for such pre approved services.

11 Impairment

The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2019				
Impact of transfers between stages	**(17)**	**51**	**161**	**195**
Other changes in credit quality	**(5)**	**(90)**	**457**	**362**
Additions (repayments)	**26**	**(49)**	**(81)**	**(104)**
Other items	**–**	**–**	**(3)**	**(3)**
	21	**(139)**	**373**	**255**
Total impairment	**4**	**(88)**	**534**	**450**
In respect of:				
Loans and advances to customers	**5**	**(93)**	**536**	**448**
Due from fellow Lloyds Banking Group undertakings	**(3)**	**–**	**–**	**(3)**
Financial assets at amortised cost	**2**	**(93)**	**536**	**445**
Loan commitments and financial guarantees	**2**	**5**	**(2)**	**5**
Total impairment	**4**	**(88)**	**534**	**450**

The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2018				
Impact of transfers between stages	18	(37)	192	173
Other changes in credit quality	(41)	(17)	246	188
Additions (repayments)	(12)	(87)	(45)	(144)
Other items	–	–	(23)	(23)
	(53)	(104)	178	21
Total impairment	(35)	(141)	370	194
In respect of:				
Loans and advances to customers	(14)	(115)	369	240
Due from fellow Lloyds Banking Group undertakings	(8)	–	–	(8)
Financial assets at amortised cost	(22)	(115)	369	232
Loan commitments and financial guarantees	(13)	(26)	1	(38)
Total impairment	(35)	(141)	370	194

The Group's impairment charge comprises the following items:

Transfers between stages
The net impact on the impairment charge of transfers between stages.

Other changes in credit quality
Changes in loss allowance as a result of movements in risk parameters that reflect changes in customer quality, but which have not resulted in a transfer to a different stage. This also contains the impact on the impairment charge as a result of write-offs and recoveries, where the related loss allowances are reassessed to reflect ultimate realisable or recoverable value.

11 Impairment (continued)

Additions (repayments)
Expected loss allowances are recognised on origination of new loans or further drawdowns of existing facilities. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

Movements in the Group's impairment allowances are shown in note 17.

12 Tax expense

a Analysis of tax expense for the year

The Group	2019 £m	2018[1] £m
UK corporation tax:		
Current tax on profit for the year	(463)	(461)
Adjustments in respect of prior years	15	8
	(448)	(453)
Foreign tax:		
Current tax on profit for the year	(24)	(17)
Adjustments in respect of prior years	–	–
	(24)	(17)
Current tax expense	(472)	(470)
Deferred tax (note 28):		
Current year	(111)	(183)
Adjustments in respect of prior years	(21)	(10)
	(132)	(193)
Tax expense	(604)	(663)

1 Restated, see note 1.

b Factors affecting the tax expense for the year

The UK corporation tax rate for the year was 19 per cent (2018: 19 per cent). An explanation of the relationship between tax expense and accounting profit is set out below:

The Group	2019 £m	2018[1] £m
Profit before tax	1,278	2,231
UK corporation tax thereon	(243)	(424)
Impact of surcharge on banking profits	(165)	(176)
Non-deductible costs: conduct charges	(171)	(34)
Other non-deductible costs	(45)	(12)
Non-taxable income	13	(2)
Tax relief on coupons on other equity instruments	19	19
Tax-exempt losses on disposals	–	(5)
Derecognition of losses that arose in prior years	–	(9)
Remeasurement of deferred tax due to rate changes	(5)	(18)
Differences in overseas tax rates	(1)	–
Adjustments in respect of prior years	(6)	(2)
Tax expense	(604)	(663)

1 Restated, see note 1.

13 Financial assets at fair value through profit or loss

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Trading assets	**–**	–	**–**	–
Loans and advances to customers mandatorily at fair value through profit or loss	**463**	509	**117**	110
Total	**463**	509	**117**	110

At 31 December 2019 £463 million (2018: £509 million) of trading and other financial assets at fair value through profit or loss of the Group and £117 million (2018: £110 million) of the Bank had a contractual residual maturity of greater than one year.

For amounts included above which are subject to repurchase and reverse repurchase agreements see note 40.

14 Derivative financial instruments

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

The Group	2019 Contract/ notional amount £m	2019 Fair value assets £m	2019 Fair value liabilities £m	2018 Contract/ notional amount £m	2018 Fair value assets £m	2018 Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**2,690**	**65**	**15**	1,855	120	8
Currency swaps	**38,095**	**927**	**865**	41,752	912	716
Options purchased	**24**	**1**	**–**	74	3	–
Options written	**24**	**–**	**1**	74	–	3
	40,833	**993**	**881**	43,755	1,035	727
Interest rate contracts:						
Interest rate swaps	**170,525**	**7,800**	**9,173**	168,031	5,887	7,559
Forward rate agreements	**–**	**–**	**–**	6,514	1	1
Options purchased	**323**	**12**	**–**	458	35	–
Options written	**359**	**–**	**1**	641	–	26
	171,207	**7,812**	**9,174**	175,644	5,923	7,586
Credit derivatives	**1,588**	**6**	**17**	3,776	21	21
Equity and other contracts	**102**	**4**	**284**	218	1	328
Total derivative assets/liabilities held for trading	**213,730**	**8,815**	**10,356**	223,393	6,980	8,662
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**6,051**	**880**	**170**	11,186	1,693	368
Cross currency swaps	**–**	**–**	**–**	–	–	–
	6,051	**880**	**170**	11,186	1,693	368
Derivatives designated as cash flow hedges:						
Interest rate swaps	**13,227**	**643**	**826**	19,464	688	1,178
Futures	**–**	**–**	**–**	–	–	–
	13,227	**643**	**826**	19,464	688	1,178
Total derivative assets/liabilities held for hedging	**19,278**	**1,523**	**996**	30,650	2,381	1,546
Total recognised derivative assets/liabilities	**233,008**	**10,338**	**11,352**	254,043	9,361	10,208

The notional amount of the contract does not represent the Group's exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group 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; a large proportion of the Group's derivatives are held through exchanges such as London Clearing House and are collateralised through those exchanges. Further details are provided in note 43 Credit risk.

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; and
- 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 and cash flow hedge approaches as described in note 43.

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.
- 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.

14 Derivative financial instruments (continued)

Details of the Group's hedging instruments are set out below:

	Maturity					
The Group – 31 December 2019	**Up to 1 month £m**	**1-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	**1,118**	**88**	**3,205**	**1,640**	**6,051**
Average fixed interest rate	–	**3.87%**	**3.58%**	**4.65%**	**5.73%**	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	**138**	–	**2,143**	**4,748**	**6,198**	**13,227**
Average fixed interest rate	**4.80%**	–	**2.04%**	**1.57%**	**2.91%**	

	Maturity					
The Group – 31 December 2018	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	67	4	1,366	4,939	4,810	11,186
Average fixed interest rate	1.17%	5.10%	4.83%	4.65%	5.07%	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	87	868	1,505	8,092	8,912	19,464
Average fixed interest rate	4.91%	1.42%	1.37%	2.83%	2.73%	

The carrying amounts of the Group's hedging instruments are as follows:

	Carrying amount of the hedging instrument			
The Group – 31 December 2019	**Contract/notional amount £m**	**Assets £m**	**Liabilities £m**	**Changes in fair value used for calculating hedge ineffectiveness (YTD) £m**
Fair value hedges				
Interest rate				
Interest rate swaps	**6,051**	**880**	**170**	**(94)**
Cash flow hedges				
Interest rate				
Interest rate swaps	**13,227**	**643**	**826**	**137**

	Carrying amount of the hedging instrument			
The Group – 31 December 2018	Contract/notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness (YTD) £m
Fair value hedges				
Interest rate				
Interest rate swaps	11,186	1,693	368	(371)
Cash flow hedges				
Interest rate				
Interest rate swaps	19,464	688	1,178	7

All amounts are held within derivative financial instruments.

14 Derivative financial instruments (continued)

The Group's hedged items are as follows:

The Group – 31 December 2019	**Carrying amount of the hedged item**		**Accumulated amount of fair value adjustment on the hedged item**		**Change in fair value of hedged item for ineffectiveness assessment (YTD)**	**Cash flow hedge reserve**	
	Assets £m	**Liabilities £m**	**Assets £m**	**Liabilities £m**	**£m**	**Continuing hedges £m**	**Discontinued hedges £m**
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**–**	**6,487**	**–**	**749**	**93**		
Fixed rate bonds[2]	**722**	**–**	**5**	**–**	**4**		
Cash flow hedges							
Interest rate							
Customer loans[3]					**(264)**	**(37)**	**(70)**
Customer deposits[4]					**128**	**18**	**34**

The Group – 31 December 2018	Carrying amount of the hedged item		Accumulated amount of fair value adjustment on the hedged item		Change in fair value of hedged item for ineffectiveness assessment (YTD)	Cash flow hedge reserve	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m	Continuing hedges £m	Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	–	6,641	–	40	367		
Fixed rate bonds[2]	180	–	–	–	–		
Cash flow hedges							
Interest rate							
Customer loans[3]					(25)	(179)	(39)
Customer deposits[4]					15	101	23

1 Included within debt securities in issue.

2 Included within financial assets at fair value through other comprehensive income.

3 Included within loans and advances to customers.

4 Included within customer deposits.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is a liability of £415 million (2018: liability of £486 million).

Gains and losses arising from hedge accounting are summarised as follows:

The Group – 31 December 2019	**Gain (loss) recognised in other comprehensive income £m**	**Hedge ineffectiveness recognised in the income statement[1] £m**	**Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m**	**Income statement line item that includes reclassified amount**
Fair value hedges				
Interest rate				
Fixed rate issuance		**4**		
Fixed rate bonds		**–**		
Cash flow hedges				
Interest rate				
Customer loans	**75**	**–**	**72**	Interest income
Customer deposits	**(36)**	**–**	**(35)**	Interest expense

14 Derivative financial instruments (continued)

The Group – 31 December 2018	Gain (loss) recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m	Income statement line item that includes reclassified amount
Fair value hedges				
Interest rate				
Fixed rate issuance		(4)		
Cash flow hedges				
Interest rate				
Customer loans	(300)	6	(67)	Interest income
Customer deposits	175	(4)	39	Interest expense

1 Hedge ineffectiveness is included in the income statement within net trading income.

There were no amounts reclassified from the cash flow hedging reserve in 2018 or 2019 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

At 31 December 2019 £10,084 million of total recognised derivative assets of the Group and £11,184 million of total recognised derivative liabilities of the Group (2018: £9,200 million of assets and £10,082 million of liabilities) had a contractual residual maturity of greater than one year.

The Bank	**2019 Contract/ notional amount £m**	**2019 Fair value assets £m**	**2019 Fair value liabilities £m**	2018 Contract/ notional amount £m	2018 Fair value assets £m	2018 Fair value liabilities £m
Trading						
Exchange rate contracts:						
Spot, forwards and futures	**1,360**	**23**	**15**	729	13	8
Currency swaps	**38,086**	**927**	**857**	41,722	883	716
Options purchased	**24**	**1**	**–**	74	3	–
Options written	**24**	**–**	**1**	74	–	3
	39,494	**951**	**873**	42,599	899	727
Interest rate contracts:						
Interest rate swaps	**170,525**	**7,800**	**9,157**	168,030	5,887	7,540
Forward rate agreements	**–**	**–**	**–**	6,514	1	1
Options purchased	**323**	**12**	**–**	458	35	1
Options written	**359**	**–**	**1**	641	–	25
	171,207	**7,812**	**9,158**	175,643	5,923	7,567
Credit derivatives	**1,588**	**6**	**17**	–	21	21
Equity and other contracts	**51**	**4**	**4**	3,940	1	3
Total derivative assets/liabilities held for trading	**212,340**	**8,773**	**10,052**	222,182	6,844	8,318
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**6,051**	**880**	**170**	11,186	1,693	368
Cross currency swaps	**–**	**–**	**–**	–	–	–
	6,051	**880**	**170**	11,186	1,693	368
Derivatives designated as cash flow hedges:						
Interest rate swaps	**13,227**	**643**	**826**	19,464	688	1,178
Futures	**–**	**–**	**–**	–	–	–
	13,227	**643**	**826**	19,464	688	1,178
Total derivative assets/liabilities held for hedging	**19,278**	**1,523**	**996**	30,650	2,381	1,546
Total recognised derivative assets/liabilities	**231,618**	**10,296**	**11,048**	252,832	9,225	9,864

14 Derivative financial instruments (continued)

Details of the Bank's hedging instruments are set out below:

The Bank – 31 December 2019	**Maturity**					
	Up to 1 month £m	**1-3 months £m**	**3 - 12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	**1,118**	**88**	**3,205**	**1,640**	**6,051**
Average fixed interest rate	–	**3.87%**	**3.58%**	**4.65%**	**5.73%**	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	**138**	–	**2,143**	**4,748**	**6,198**	**13,227**
Average fixed interest rate	**4.80%**	–	**2.04%**	**1.57%**	**2.91%**	

The Bank – 31 December 2018	Maturity					
	Up to 1 month £m	1-3 months £m	3 - 12 months £m	1-5 years £m	Over 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	67	4	1,366	4,939	4,810	11,186
Average fixed interest rate	1.17%	5.10%	4.83%	4.65%	5.07%	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	87	868	1,505	8,092	8,912	19,464
Average fixed interest rate	4.91%	1.42%	1.37%	2.83%	2.73%	

The carrying amounts of the Bank's hedging instruments are as follows:

The Bank – 31 December 2019		**Carrying amount of the hedging instrument**		
	Contract/notional amount £m	**Assets £m**	**Liabilities £m**	**Changes in fair value used for calculating hedge ineffectiveness (YTD) £m**
Fair value hedges				
Interest rate				
Interest rate swaps	**6,051**	**880**	**170**	**(94)**
Cash flow hedges				
Interest rate				
Interest rate swaps	**13,227**	**643**	**826**	**137**

The Bank – 31 December 2018		Carrying amount of the hedging instrument		
	Contract/notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness (YTD) £m
Fair value hedges				
Interest rate				
Interest rate swaps	11,186	1,693	368	(371)
Cash flow hedges				
Interest rate				
Interest rate swaps	19,464	688	1,178	7

All amounts are held within derivative financial instruments.

14 Derivative financial instruments (continued)

The Bank's hedged items are as follows:

The Bank – 31 December 2019	**Carrying amount of the hedged item**		**Accumulated amount of fair value adjustment on the hedged item**		**Change in fair value of hedged item for ineffectiveness assessment (YTD)**	**Cash flow hedge reserve**	
	Assets £m	**Liabilities £m**	**Assets £m**	**Liabilities £m**	**£m**	**Continuing hedges £m**	**Discontinued hedges £m**
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**–**	**6,487**	**–**	**749**	**93**		
Fixed rate bonds[2]	**722**	**–**	**5**	**–**	**4**		
Cash flow hedges							
Interest rate							
Customer loans[3]					**(264)**	**(37)**	**(70)**
Customer deposits[4]					**128**	**18**	**34**

The Bank – 31 December 2018	Carrying amount of the hedged item		Accumulated amount of fair value adjustment on the hedged item		Change in fair value of hedged item for ineffectiveness assessment (YTD)	Cash flow hedge reserve	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m	Continuing hedges £m	Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	–	6,641	–	40	367		
Fixed rate bonds[2]	180	–	–	–	–		
Cash flow hedges							
Interest rate							
Customer loans[3]					(25)	(179)	(39)
Customer deposits[4]					15	101	23

1 Included within debt securities in issue.

2 Included within financial assets at fair value through other comprehensive income.

3 Included within loans and advances to customers.

4 Included within customer deposits.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is a liability £415 million (2018: liability of £486 million).

Gains and losses arising from hedge accounting are summarised as follows:

The Bank – 31 December 2019	**Gain (loss) recognised in other comprehensive income £m**	**Hedge ineffectiveness recognised in the income statement[1] £m**	**Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m**	**Income statement line item that includes reclassified amount**
Fair value hedges				
Interest rate				
Fixed rate issuance		**4**		
Fixed rate bonds		**–**		
Cash flow hedges				
Interest rate				
Customer loans	**75**	**–**	**72**	Interest income
Customer deposits	**(36)**	**–**	**(35)**	Interest expense

14 Derivative financial instruments (continued)

The Bank – 31 December 2018	(Loss) gain recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m	Income statement line item that includes reclassified amount
Fair value hedges				
Interest rate				
Fixed rate issuance		(4)		
Cash flow hedges				
Interest rate				
Customer loans	(300)	6	(67)	Interest income
Customer deposits	175	(4)	39	Interest expense

1 Hedge ineffectiveness is included in the income statement within net interest income.

There were no amounts reclassified from the cash flow hedging reserve in 2018 or 2019 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

At 31 December 2019 £10,099 million of total recognised derivative assets of the Bank and £10,875 million of total recognised derivative liabilities of the Bank (2018: £9,064 million of assets and £9,738 million of liabilities) had a contractual residual maturity of greater than one year.

15 Financial assets at amortised cost

The Group
Loans and advances to banks

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	471	–	–	471
Exchange and other adjustments	(20)	–	–	(20)
Repayments	(140)	–	–	(140)
At 31 December 2019	311	–	–	311
Allowance for impairment losses	–	–	–	–
Total loans and advances to banks	311	–	–	311

Loans and advances to customers

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	232,951	25,345	6,143	264,439
Exchange and other adjustments	(265)	(15)	25	(255)
Additions (repayments)	7,162	(2,583)	(1,102)	3,477
Transfers to Stage 1	4,524	(4,515)	(9)	–
Transfers to Stage 2	(7,591)	8,502	(911)	–
Transfers to Stage 3	(677)	(1,378)	2,055	–
	(3,744)	2,609	1,135	–
Recoveries			169	169
Disposal of businesses	(6,363)	(360)	(42)	(6,765)
Financial assets that have been written off during the year			(665)	(665)
At 31 December 2019	229,741	24,996	5,663	260,400
Allowance for impairment losses	(149)	(749)	(1,187)	(2,085)
Total loans and advances to customers	229,592	24,247	4,476	258,315

Debt securities

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	–	–	13	13
Financial assets that have been written off during the year			(12)	(12)
At 31 December 2019	–	–	1	1
Allowance for impairment losses	–	–	(1)	(1)
Total debt securities	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	97,541	–	–	97,541
Allowance for impairment losses	(7)	–	–	(7)
Due from fellow Lloyds Banking Group undertakings, net of impairment allowance	97,534	–	–	97,534
Total financial assets at amortised cost	327,437	24,247	4,476	356,160

15 Financial assets at amortised cost (continued)

The Group
Loans and advances to banks

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2018	518	–	–	518
Exchange and other adjustments	1	–	–	1
Repayments	(48)	–	–	(48)
At 31 December 2018	471	–	–	471
Allowance for impairment losses	–	–	–	–
Total loans and advances to banks	471	–	–	471

Loans and advances to customers

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2018	226,533	37,768	6,039	270,340
Exchange and other adjustments	108	(20)	(2)	86
Additions (repayments)	2,903	(2,104)	(1,287)	(488)
Transfers to Stage 1[1]	11,361	(11,350)	(11)	–
Transfers to Stage 2	(6,731)	7,470	(739)	–
Transfers to Stage 3	(680)	(2,395)	3,075	–
	3,950	(6,275)	2,325	–
Recoveries			218	218
Disposal of businesses	(543)	(4,024)	(553)	(5,120)
Financial assets that have been written off during the year			(597)	(597)
At 31 December 2018	232,951	25,345	6,143	264,439
Allowance for impairment losses	(149)	(858)	(1,108)	(2,115)
Total loans and advances to customers	232,802	24,487	5,035	262,324

Debt securities

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2018	–	–	30	30
Exchange and other adjustments	–	–	(10)	(10)
Financial assets that have been written off during the year			(7)	(7)
At 31 December 2018	–	–	13	13
Allowance for impairment losses	–	–	(13)	(13)
Total debt securities	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	58,943	–	–	59,943
Allowance for impairment losses	(11)	–	–	(11)
Due from fellow Lloyds Banking Group undertakings, net of impairment allowance	58,932	–	–	58,932
Total financial assets at amortised cost	292,205	24,487	5,035	321,727

1 Includes the effects of the changes in transfer criteria approach for mortgages.

Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December.

Additions (repayments) comprise new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to Stage 3 before acquiring a full allowance and subsequent write-off.

15 Financial assets at amortised cost (continued)

The Bank
Loans and advances to banks

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	471	–	–	471
Exchange and other adjustments	(20)	–	–	(20)
Repayments	(144)	–	–	(144)
At 31 December 2019	307	–	–	307
Allowance for impairment losses	–	–	–	–
Total loans and advances to banks	307	–	–	307

Loans and advances to customers

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	229,138	24,086	5,676	258,900
Exchange and other adjustments	(233)	(15)	27	(221)
Additions (repayments)	6,899	(2,464)	(998)	3,437
Transfers to Stage 1	4,315	(4,306)	(9)	–
Transfers to Stage 2	(7,371)	8,198	(827)	–
Transfers to Stage 3	(682)	(1,282)	1,964	–
	(3,738)	2,610	1,128	–
Recoveries			164	164
Disposal of businesses	(6,363)	(360)	(42)	(6,765)
Financial assets that have been written off during the year			(648)	(648)
At 31 December 2019	225,703	23,857	5,307	254,867
Allowance for impairment losses	(147)	(682)	(1,107)	(1,936)
Total loans and advances to customers	225,556	23,175	4,200	252,931

Debt securities

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	–	–	13	13
Financial assets that have been written off during the year	–	–	(12)	(12)
At 31 December 2019	–	–	1	1
Allowance for impairment losses	–	–	(1)	(1)
Total debt securities	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	108,945	–	106	109,051
Allowance for impairment losses	(10)	–	(106)	(116)
Due from fellow Lloyds Banking Group undertakings, net of impairment allowance	108,935	–	–	108,935
Total financial assets at amortised cost	334,798	23,175	4,200	362,173

15 Financial assets at amortised cost (continued)

The Bank
Loans and advances to banks

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2018	518	–	–	518
Exchange and other adjustments	1	–	–	1
Repayments	(48)	–	–	(48)
At 31 December 2018	471	–	–	471
Allowance for impairment losses	–	–	–	–
Total loans and advances to banks	471	–	–	471

Loans and advances to customers

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2018	222,535	36,192	5,563	264,290
Exchange and other adjustments	103	(29)	–	74
Additions (repayments)	3,169	(1,962)	(1,159)	48
Transfers to Stage 1	11,051	(11,040)	(11)	–
Transfers to Stage 2	(6,517)	7,214	(697)	–
Transfers to Stage 3	(660)	(2,265)	2,925	–
	3,874	(6,091)	2,217	–
Recoveries			190	190
Disposal of businesses	(543)	(4,024)	(553)	(5,120)
Financial assets that have been written off during the year			(582)	(582)
At 31 December 2018	229,138	24,086	5,676	258,900
Allowance for impairment losses	(147)	(773)	(990)	(1,910)
Total loans and advances to customers	228,991	23,313	4,686	256,990

Debt securities

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2018	–	–	27	27
Exchange and other adjustments	–	–	(7)	(7)
Financial assets that have been written off during the year	–	–	(7)	(7)
At 31 December 2018	–	–	13	13
Allowance for impairment losses	–	–	(13)	(13)
Total debt securities	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	69,931	–	–	69,931
Allowance for impairment losses	(16)	–	–	(16)
Due from fellow Lloyds Banking Group undertakings, net of impairment allowance	69,915	–	–	69,915
Total financial assets at amortised cost	299,377	23,313	4,686	327,376

Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December.

Additions (repayments) comprise new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to stage 3 before acquiring a full allowance and subsequent write-off.

At 31 December 2019 £245,357 million (2018: £246,381 million) of loans and advances to customers of the Group and £240,181 million (2018: £241,453 million) of the Bank had a contractual residual maturity of greater than one year.

At 31 December 2019 £265 million (2018: £309 million) of loans and advances to banks of the Group and £265 million (2018: £309 million) of the Bank had a contractual residual maturity of greater than one year.

16 Finance lease receivables

The Group's finance lease receivables are classified as loans and advances to customers and accounted for at amortised cost. The balance is analysed as follows:

The Group	2019 £m	2018 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**29**	27
Later than 1 year and not later than 2 years	**32**	28
Later than 2 years and not later than 3 years	**32**	29
Later than 3 years and not later than 4 years	**50**	30
Later than 4 years and not later than 5 years	**29**	56
Later than 5 years	**200**	219
	372	389
Unearned future finance income on finance leases	**(120)**	(120)
Rentals received in advance	**(1)**	(1)
Net investment in finance leases	**251**	268

The Group	2019 £m	2018 £m
Not later than 1 year	**10**	8
Later than 1 year and not later than 2 years	**16**	17
Later than 2 years and not later than 3 years	**17**	18
Later than 3 years and not later than 4 years	**37**	19
Later than 4 years and not later than 5 years	**17**	35
Later than 5 years	**154**	171
Net investment in finance leases	**251**	268

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. There was an allowance for uncollectable finance lease receivables included in the allowance for impairment losses for the Group of £nil (2018: £1 million).

17 Allowance for impairment losses

Analysis of movement in the allowance for impairment losses by Stage.

The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2019	160	858	1,121	2,139
Exchange and other adjustments	–	(7)	64	57
Transfers to Stage 1	80	(76)	(4)	–
Transfers to Stage 2	(22)	115	(93)	–
Transfers to Stage 3	(10)	(118)	128	–
Impact of transfers between stages	(65)	129	130	194
	(17)	50	161	194
Other items charged to the income statement	19	(143)	375	251
Charge to the income statement (note 11)	2	(93)	536	445
Advances written off			(677)	(677)
Disposal of businesses	(6)	(9)	(14)	(29)
Recoveries of advances written off in previous years			169	169
Discount unwind			(11)	(11)
At 31 December 2019	156	749	1,188	2,093
In respect of undrawn balances				
Balance at 1 January 2019	24	23	3	50
Transfers to Stage 1	5	(5)	–	–
Transfers to Stage 2	(1)	1	–	–
Transfers to Stage 3	–	(1)	1	–
Impact of transfers between stages	(4)	6	(1)	1
	–	1	–	1
Other items charged to the income statement	2	4	(2)	4
Charge to the income statement	2	5	(2)	5
At 31 December 2019	26	28	1	55
Total	182	777	1,189	2,148
In respect of:				
Loans and advances to customers	149	749	1,187	2,085
Debt securities	–	–	1	1
Due from fellow Lloyds Banking Group undertakings	7	–	–	7
Financial assets at amortised cost	156	749	1,188	2,093
Provisions in relation to loan commitments and financial guarantees	26	28	1	55
Total	182	777	1,189	2,148

17 Allowance for impairment losses (continued)

Analysis of movement in the allowance for impairment losses by Stage.

The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2018	164	1,076	1,260	2,500
Exchange and other adjustments	18	(1)	41	58
Transfers to Stage 1	137	(134)	(3)	–
Transfers to Stage 2	(14)	92	(78)	–
Transfers to Stage 3	(8)	(111)	119	–
Impact of transfers between stages	(95)	120	152	177
	20	(33)	190	177
Other items charged to the income statement	(42)	(82)	179	55
Charge to the income statement (note 11)	(22)	(115)	369	232
Advances written off			(604)	(604)
Disposal of businesses[1]	–	(102)	(162)	(264)
Recoveries of advances written off in previous years			218	218
Discount unwind			(1)	(1)
At 31 December 2018	160	858	1,121	2,139
In respect of undrawn balances				
Balance at 1 January 2018	37	50	–	87
Exchange and other adjustments	–	(1)	2	1
Transfers to Stage 1	11	(11)	–	–
Transfers to Stage 2	(2)	2	–	–
Transfers to Stage 3	(1)	(2)	3	–
Impact of transfers between stages	(10)	7	(1)	(4)
	(2)	(4)	2	(4)
Other items charged to the income statement	(11)	(22)	(1)	(34)
Charge to the income statement	(13)	(26)	1	(38)
At 31 December 2018	24	23	3	50
Total	184	881	1,124	2,189
In respect of:				
Loans and advances to customers	149	858	1,108	2,115
Debt securities	–	–	13	13
Due from fellow Lloyds Banking Group undertakings	11	–	–	11
Financial assets at amortised cost	160	858	1,121	2,139
Provisions in relation to loan commitments and financial guarantees	24	23	3	50
Total	184	881	1,124	2,189

1 Reflected the transfer of assets to Lloyds Bank Corporate Markets plc and the sale of the Group's Irish mortgage portfolio.

The Group income statement charge comprises:

	2019 £m	2018 £m
Drawn balances	**445**	232
Undrawn balances	**5**	(38)
Total	**450**	194

17 Allowance for impairment losses (continued)

The Bank	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2019	163	773	1,003	1,939
Exchange and other adjustments	(1)	(7)	67	59
Transfers to Stage 1	75	(71)	(4)	–
Transfers to Stage 2	(21)	99	(78)	–
Transfers to Stage 3	(9)	(105)	114	–
Impact of transfers between stages	(60)	125	124	189
	(15)	48	156	189
Other items charged to the income statement	16	(123)	513	406
Charge to the income statement	1	(75)	669	595
Advances written off			(660)	(660)
Disposal of business	(6)	(9)	(14)	(29)
Recoveries of advances written off in previous years			164	164
Discount unwind			(15)	(15)
At 31 December 2019	157	682	1,214	2,053
In respect of undrawn balances				
Balance at 1 January 2019	24	23	3	50
Transfers to Stage 1	5	(5)	–	–
Transfers to Stage 2	(1)	1	–	–
Transfers to Stage 3	–	(1)	1	–
Impact of transfers between stages	(4)	6	(1)	1
	–	1	–	1
Other items charged to the income statement	2	4	(2)	4
Charge to the income statement	2	5	(2)	5
At 31 December 2019	26	28	1	55
Total	183	710	1,215	2,108
In respect of:				
Loans and advances to customers	147	682	1,107	1,936
Debt securities	–	–	1	1
Due from fellow Lloyds Banking Group undertakings	10	–	106	116
Financial assets at amortised cost	157	682	1,214	2,053
Provisions in relation to loan commitments and financial guarantees	26	28	1	55
Total	183	710	1,215	2,108

17 Allowance for impairment losses (continued)

The Bank	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2018	182	974	1,152	2,308
Exchange and other adjustments	1	(1)	(42)	(42)
Transfers to Stage 1	131	(128)	(3)	–
Transfers to Stage 2	(14)	80	(66)	–
Transfers to Stage 3	(8)	(94)	102	–
Impact of transfers between stages	(90)	115	136	161
	19	(27)	169	161
Other items charged to the income statement	(39)	(71)	206	96
Charge to the income statement	(20)	(98)	375	257
Advances written off			(589)	(589)
Disposal of business	–	(102)	(79)	(181)
Recoveries of advances written off in previous years			190	190
Discount unwind			(4)	(4)
At 31 December 2018	163	773	1,003	1,939
In respect of undrawn balances				
Balance at 1 January 2018	37	50	–	87
Exchange and other adjustments	–	(1)	2	1
Transfers to Stage 1	11	(11)	–	–
Transfers to Stage 2	(2)	2	–	–
Transfers to Stage 3	(1)	(2)	3	–
Impact of transfers between stages	(10)	7	(1)	(4)
	(2)	(4)	2	(4)
Other items charged to the income statement	(11)	(22)	(1)	(34)
Charge to the income statement	(13)	(26)	1	(38)
At 31 December 2018	24	23	3	50
Total	187	796	1,006	1,989
In respect of:				
Loans and advances to customers	147	773	990	1,910
Debt securities	–	–	13	13
Due from fellow Lloyds Banking Group undertakings	16	–	–	16
Financial assets at amortised cost	163	773	1,003	1,939
Provisions in relation to loan commitments and financial guarantees	24	23	3	50
Total	187	796	1,006	1,989

Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December. As assets are transferred between stages, the resulting change in expected credit loss of £194 million for the Group and £189 million for the Bank for drawn balances, and £1 million for the Group and the Bank for undrawn balances, is presented separately as Impact of transfers between stages, in the stage in which the expected credit loss is recognised at the end of the reporting period.

Other items charged to the income statement include the movements in the expected credit loss as a result of new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to Stage 3 before acquiring a full allowance and subsequent write-off. Consequently, recoveries on assets previously written-off also occur in Stage 3 only.

18 Financial assets at fair value through other comprehensive income

31 December 2019	**The Group £m**	**The Bank £m**
Corporate and other debt securities	**2,253**	**2,253**
Total financial assets at fair value through other comprehensive income	**2,253**	**2,253**

31 December 2018	The Group £m	The Bank £m
Corporate and other debt securities	968	968
Total financial assets at fair value through other comprehensive income	968	968

At 31 December 2019 £2,126 million (2018: £859 million) of financial assets at fair value through other comprehensive income of the Group and £2,126 million (2018: £859 million) of the Bank had a contractual residual maturity of greater than one year.

All assets have been assessed at Stage 1 at 1 January and 31 December 2019.

19 Goodwill

	The Group		**The Bank**	
Cost[1]	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Cost	**325**	325	**325**	325
Accumulated impairment losses	**–**	–	**–**	–
Balance sheet amount at 31 December	**325**	325	**325**	325

1 For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is 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. This compares the estimated recoverable amount, being the higher of a cash-generating unit's fair value less costs to sell and its value in use, with the carrying value. When this indicates that the carrying value is not recoverable it is written down through the income statement as goodwill impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; the entire balance of £325 million (2018: £325 million) has been allocated to retail banking activities.

The recoverable amount of goodwill carried at 31 December 2019 has been based upon value in use. This calculation uses cash flow projections based upon the five year business plan where the main assumptions used for planning purposes relate to the current economic outlook and opinions in respect of economic growth, unemployment, property markets, interest rates and credit quality. Cash flows for the period subsequent to the term of the business plan are not considered for the purposes of impairment testing. The discount rate used in discounting the projected cash flows is 10 per cent (pre-tax) reflecting, inter alia, the perceived risks within those businesses. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount to fall below the balance sheet carrying value.

20 Other intangible assets

	The Group				The Bank		
	Purchased credit card relationships £m	Brands £m	Capitalised software enhancements £m	Total £m	Purchased credit card relationships £m	Capitalised software enhancements £m	Total £m
Cost:							
At 1 January 2018	15	10	228	253	15	228	243
Exchange and other adjustments	–	–	34	34	–	34	34
Additions	–	–	43	43	–	43	43
Disposals and write-offs	(15)	–	(10)	(25)	(15)	(10)	(25)
At 31 December 2018	–	10	295	305	–	295	295
Additions	**–**	**–**	**51**	**51**	**–**	**51**	**51**
Disposals and write-offs	**–**	**(10)**	**(2)**	**(12)**	**–**	**(2)**	**(2)**
At 31 December 2019	**–**	**–**	**344**	**344**	**–**	**344**	**344**
Accumulated amortisation:							
At 1 January 2018	14	10	117	141	14	117	131
Exchange and other adjustments	–	–	30	30	–	30	30
Charge for the year (note 9)	1	–	35	36	1	35	36
Disposals and write-offs	(15)	–	(7)	(22)	(15)	(7)	(22)
At 31 December 2018	–	10	175	185	–	175	175
Charge for the year (note 9)	**–**	**–**	**31**	**31**	**–**	**31**	**31**
Disposals and write-offs	**–**	**(10)**	**–**	**(10)**	**–**	**–**	**–**
At 31 December 2019	**–**	**–**	**206**	**206**	**–**	**206**	**206**
Balance sheet amount at 31 December 2019	**–**	**–**	**138**	**138**	**–**	**138**	**138**
Balance sheet amount at 31 December 2018	**–**	**–**	**120**	**120**	**–**	**120**	**120**

Capitalised software enhancements principally comprise identifiable and directly associated internal staff and other costs.

21 Property, plant and equipment

	The Group						The Bank			
	Investment properties £m	Premises £m	Equipment £m	Operating lease assets £m	Right-of-use asset[1] £m	Total £m	Premises £m	Equipment £m	Right-of-use asset[1] £m	Total £m
Cost or valuation:										
At 1 January 2018	49	874	659	9		1,591	838	646		1,484
Additions	–	13	67	38		118	13	67		80
Expenditure on investment properties	17	–	–	–		17	–	–		–
Disposals	(31)	(137)	(185)	(1)		(354)	(136)	(184)		(320)
At 31 December 2018	35	750	541	46		1,372	715	529		1,244
Adjustment on adoption of IFRS 16 (note 46)	–	–	–	–	748	748	–	–	748	748
At 1 January 2019	**35**	**750**	**541**	**46**	**748**	**2,120**	**715**	**529**	**748**	**1,992**
Additions	**–**	**56**	**32**	**–**	**81**	**169**	**56**	**32**	**81**	**169**
Expenditure on investment properties	**13**	**–**	**–**	**–**	**–**	**13**	**–**	**–**	**–**	**–**
Charge in fair value of investment properties	**(8)**	**–**	**–**	**–**	**–**	**(8)**	**–**	**–**	**–**	**–**
Disposals	**(25)**	**(51)**	**(12)**	**(46)**	**(10)**	**(144)**	**(34)**	**–**	**(10)**	**(44)**
At 31 December 2019	**15**	**755**	**561**	**–**	**819**	**2,150**	**737**	**561**	**819**	**2,117**
Accumulated depreciation and impairment:										
At 1 January 2018	–	468	298	2		768	453	289		742
Exchange and other adjustments	–	(11)	(8)	6		(13)	–	–		–
Depreciation charge for the year (note 9)	–	54	68	4		126	54	68		122
Disposals	–	(137)	(148)	(1)		(286)	(149)	(148)		(297)
At 31 December 2018	–	374	210	11		595	358	209		567
Depreciation charge for the year (note 9)	**–**	**54**	**59**	**–**	**91**	**204**	**54**	**59**	**91**	**204**
Disposals	**–**	**(39)**	**(4)**	**(11)**	**(2)**	**(56)**	**(23)**	**(3)**	**(2)**	**(28)**
At 31 December 2019	**–**	**389**	**265**	**–**	**89**	**743**	**389**	**265**	**89**	**743**
Balance sheet amount at 31 December 2019	**15**	**366**	**296**	**–**	**730**	**1,407**	**348**	**296**	**730**	**1,374**
Balance sheet amount at 31 December 2018	**35**	**376**	**331**	**35**	**–**	**777**	**357**	**320**	**–**	**677**

1 Primarily premises

The table above analyses movements in investment properties, all of which are categorised as level 3. See note 40 for details of levels in the fair value hierarchy.

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements.

22 Investment in subsidiary undertakings

The Bank	2019 £m	2018 £m
At 1 January	**83**	84
Additions and capital injections	**–**	16
Disposals	**–**	(17)
Impairment	**(9)**	–
At 31 December	**74**	83

Details of the subsidiaries and related undertakings are given on pages 137 to 138 and are incorporated by reference.

Certain subsidiary companies currently have insufficient distributable reserves to make dividend payments, however, there were no further significant restrictions on any of the Bank's subsidiaries in paying dividends or repaying loans and advances. All regulated subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

23 Other assets

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Settlement balances	**41**	63	**41**	63
Investments in joint ventures and associates	**1**	1	**1**	1
Other assets and prepayments	**314**	329	**319**	340
Total other assets	**356**	393	**361**	404

24 Financial liabilities at fair value through profit or loss

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**–**	–	**–**	–
Other deposits	**–**	50	**–**	50
Total trading liabilities	**–**	50	**–**	50
Other liabilities held at fair value through profit or loss: debt securities in issue	**47**	53	**–**	–
Financial liabilities at fair value through profit or loss	**47**	103	**–**	50

At 31 December 2019, £47 million (2018: £103 million) of financial liabilities at fair value through profit or loss of the Group and £nil (2018: £50 million) of the Bank had a contractual residual maturity of greater than one year.

25 Debt securities in issue

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Medium-term notes issued	**1,106**	1,168	**1,106**	1,162
Covered bonds (note 26)	**4,529**	6,017	**4,529**	6,017
Securitisation notes (note 26)	**5,569**	4,676	**–**	–
	11,204	11,861	**5,635**	7,179
Other amounts due to fellow Group undertakings	**–**	–	**4,065**	3,005
Total debt securities in issue	**11,204**	11,861	**9,700**	10,184

At 31 December 2019 £8,090 million (2018: £10,179 million) of debt securities in issue of the Group and £4,376 million (2018: £6,460 million) of the Bank had a contractual residual maturity of greater than one year.

26 Securitisations and covered bonds

Securitisation programmes
The Group's balance sheet includes loans securitised under the Group's securitisation programmes, the majority of which have been sold by Group companies to bankruptcy-remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by the Group company, the structured entities 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.

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 bond programmes, together with the balances of the advances 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 notes 24 and 25.

	2019		2018	
The Group	**Loans and advances securitised £m**	**Notes in issue £m**	Loans and advances securitised £m	Notes in issue £m
Securitisation programmes				
UK residential mortgages	**25,302**	**22,947**	24,433	21,897
Credit card receivables	**4,581**	**5,767**	4,502	5,263
Commercial loans	**534**	**534**	395	395
	30,417	**29,248**	29,330	27,555
Less held by the Group		**(23,632)**		(22,826)
Total securitisation programmes (notes 24 and 25)[1]		**5,616**		4,729
Covered bond programmes				
Residential mortgage-backed	**5,206**	**4,029**	7,195	5,517
Social housing loan-backed	**1,552**	**600**	1,839	1,200
	6,758	**4,629**	9,034	6,717
Less held by the Group		**(100)**		(700)
Total covered bond programmes (note 25)		**4,529**		6,017
Total securitisation and covered bond programmes		**10,145**		10,746

1 Includes £47 million (2018: £53 million) of securitisation notes accounted for at fair value through profit or loss.

Cash deposits of £2,000 million (2018: £1,843 million) which support the debt securities issued by the structured entities, the term advances related to covered bonds and other legal obligations are held by the Group. Additionally, the Group had certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2019 these obligations had not been triggered and the maximum exposure under these facilities was £12 million (2018: £21 million).

The Group has a number of covered bond programmes, for which limited liability partnerships have been established to ringfence asset pools and guarantee the covered bonds issued by the Group. At the reporting date the Group had overcollateralised these programmes as set out in the table above to meet the terms of the programmes, to secure the rating of the covered bonds and to provide operational flexibility. From time-to-time, the obligations of the Group to provide collateral may increase due to the formal requirements of the programmes. The Group may also voluntarily contribute collateral to support the ratings of the covered bonds.

The Group recognises the full liabilities associated with its securitisation and covered bond programmes within debt securities in issue, although the obligations of the Group in respect of its securitisation issuances are limited to the cash flows generated from the underlying assets. The Group could be required to provide additional support to a number of the securitisation programmes to support the credit ratings of the debt securities issued, in the form of increased cash reserves and the holding of subordinated notes. Further, certain programmes contain contractual obligations that require the Group to repurchase assets should they become credit impaired.

The Group has not provided financial or other support by voluntarily offering to repurchase assets from any of its public securitisation programmes during 2019 (2018: none).

27 Other liabilities

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Settlement balances	**261**	1	**261**	1
Lease liabilities	**770**	–	**770**	–
Other creditors and accruals	**800**	955	**648**	667
Total other liabilities	**1,831**	956	**1,679**	668

The maturity of the lease liabitlies was as follows:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Not later than 1 year	**101**	–	**101**	–
Later than 1 year and not later than 2 years	**96**	–	**96**	–
Later than 2 years and not later than 3 years	**85**	–	**85**	–
Later than 3 years and not later than 4 years	**74**	–	**74**	–
Later than 4 years and not later than 5 years	**65**	–	**65**	–
Later than 5 years	**349**	–	**349**	–
	770	–	**770**	–

The Group adopted IFRS 16 *Leases* from 1 January 2019, see note 1.

28 Deferred tax

The Group's and the Bank's deferred tax assets and liabilities are as follows:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Statutory position				
Deferred tax assets	**1,652**	1,801	**1,647**	1,800
Deferred tax liabilities	**–**	–	**–**	–
Net deferred tax asset	**1,652**	1,801	**1,647**	1,800
Tax disclosure				
Deferred tax assets	**1,687**	1,826	**1,682**	1,822
Deferred tax liabilities	**(35)**	(25)	**(35)**	(22)
Net deferred tax asset	**1,652**	1,801	**1,647**	1,800

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated balance sheet and takes into account the ability of the Group and the Bank to net assets and liabilities where there is a legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the tables below which splits the deferred tax assets and liabilities by type, before such netting.

As a result of legislation enacted in 2016, the UK corporation tax rate was due to reduce from 19 per cent to 17 per cent on 1 April 2020. The Group measures its deferred tax assets and liabilities at the value expected to be recoverable or payable in future periods, and re-measures them at each reporting date based on the most recent estimates of utilisation or settlement, including the impact of bank surcharge where appropriate. The deferred tax impact of this re-measurement in 2019 is a charge of £5 million in the income statement.

Within the March 2020 budget, the UK government stated its intention to maintain the corporation tax rate at 19 per cent on 1 April 2020. Had this rate change been substantively enacted at 31 December 2019, the effect would have been to increase net deferred tax assets by £183 million.

28 Deferred tax (continued)

Movements in deferred tax liabilities and assets (before taking into consideration the offsetting of balances within the same taxing jurisdiction) can be summarised as follows:

The Group Deferred tax assets	Tax losses £m	Property, plant and equipment £m	Provisions £m	Share-based payments £m	Other revaluations[1] £m	Derivatives £m	Other temporary differences £m	Total £m
At 1 January 2018	1,581	233	141	10	6	–	10	1,981
(Charge) credit to the income statement	(83)	(71)	(13)	(5)	(4)	(8)	(4)	(188)
Credit to other comprehensive income	–	–	–	–	1	32	–	33
At 31 December 2018	1,498	162	128	5	3	24	6	1,826
Charge (credit) to the income statement	**(96)**	**(20)**	**(36)**	**6**	**–**	**–**	**18**	**(128)**
Credit to other comprehensive income	**–**	**–**	**–**	**–**	**(1)**	**(10)**	**–**	**(11)**
At 31 December 2019	**1,402**	**142**	**92**	**11**	**2**	**14**	**24**	**1,687**

Deferred tax liabilities	Derivatives £m	Other revaluations[1] £m	Other temporary differences £m	Total £m
At 1 January 2018	(8)	–	(12)	(20)
Credit (charge) to the income statement	8	–	(13)	(5)
At 31 December 2018	–	–	(25)	(25)
Charge to the income statement	–	–	**(4)**	**(4)**
Charge to other comprehensive income	–	–	**(6)**	**(6)**
At 31 December 2019	–	**–**	**(35)**	**(35)**

The Bank Deferred tax assets	Tax losses £m	Property, plant and equipment £m	Provisions £m	Share-based payments £m	Other revaluations[1] £m	Derivatives £m	Other temporary differences £m	Total £m
At 1 January 2018	1,581	216	137	10	6	–	9	1,959
Charge to the income statement	(103)	(34)	(13)	(5)	(6)	(8)	(3)	(172)
Credit to other comprehensive income	–	–	–	–	3	32	–	35
At 31 December 2018	1,478	182	124	5	3	24	6	1,822
(Charge) credit to the income statement	**(96)**	**(19)**	**(36)**	**6**	**(3)**	**–**	**18**	**(130)**
Charge to other comprehensive income	**–**	**–**	**–**	**–**	**–**	**(10)**	**–**	**(10)**
At 31 December 2019	**1,382**	**163**	**88**	**11**	**–**	**14**	**24**	**1,682**

Deferred tax liabilities	Other revaluations[1] £m	Derivatives £m	Other temporary differences £m	Total £m
At 1 January 2018	–	(8)	(12)	(20)
(Charge) credit to the income statement	–	8	(9)	(1)
Charge to other comprehensive income	–	–	(1)	(1)
At 31 December 2018	–	–	(22)	(22)
Charge to the income statement	**(2)**	**–**	**(3)**	**(5)**
Charge to other comprehensive income	–	**–**	**(7)**	**(7)**
Exchange and other adjustments	**–**	**–**	**(1)**	**(1)**
At 31 December 2019	**(2)**	**–**	**(33)**	**(35)**

1 Financial assets at fair value through other comprehensive income.

Deferred tax not recognised

Deferred tax assets of approximately £24 million (2018: £18 million) for the Group and £24 million (2018: £18 million) for the Bank have not been recognised in respect of £139 million for the Group and £139 million for the Bank of UK tax losses and other temporary differences which can only be used to offset future capital gains. UK capital losses can be carried forward indefinitely.

In addition, no deferred tax asset is recognised in respect of unrelieved foreign tax credits of £40 million (2018 £40 million) for the Group and £40 million (2018: £40 million) for the Bank, as there are no expected future taxable profits against which the credits can be utilised. These credits can be carried forward indefinitely.

28 Deferred tax (continued)

No deferred tax has been recognised in respect of foreign trade losses where it is not more likely than not that we will be able to utilise them in future periods. Of the asset not recognised, £35 million for the Group and £nil for the Bank (2018: £36 million for the Group and £nil for the Bank) relates to losses that will expire if not used within 20 years, and £38 million for the Group and £37 million for the Bank (2018: £45 million for the Group and £42 million for the Bank) relates to losses with no expiry date.

As a result of parent company exemptions on dividends from subsidiaries and on capital gains on disposal there are no significant taxable temporary differences associated with investments in subsidiaries, branches, associates and joint arrangements.

29 Other provisions

The Group	Provisions for financial commitments and guarantees £m	Payment protection insurance £m	Other regulatory provisions £m	Other £m	Total £m
Balance at 31 December 2018	50	392	442	143	1,027
Adjustment on adoption of IFRS 16	–	–	–	**(30)**	**(30)**
Balance at 1 January 2019	**50**	**392**	**442**	**113**	**997**
Provisions applied	–	**(759)**	**(464)**	**(42)**	**(1,265)**
Charge for the year	**5**	**963**	**254**	**23**	**1,245**
At 31 December 2019	**55**	**596**	**232**	**94**	**977**

The Bank	Provisions for financial commitments and guarantees £m	Payment protection insurance £m	Other regulatory provisions £m	Other £m	Total £m
Balance at 31 December 2018	50	387	429	140	1,006
Adjustment on adoption of IFRS 16	–	–	–	**(30)**	**(30)**
Balance at 1 January 2019	**50**	**387**	**429**	**110**	**976**
Provisions applied	–	**(757)**	**(455)**	**(40)**	**(1,252)**
Charge for the year	**5**	**964**	**251**	**24**	**1,244**
At 31 December 2019	**55**	**594**	**225**	**94**	**968**

Provisions for financial commitments and guarantees
Provisions are recognised for expected credit losses on undrawn loan commitments and financial guarantees.

Payment protection insurance
The Group increased the provision for PPI costs by a further £963 million in the year ended 31 December 2019, bringing the total amount provided to £6,421 million.

The charge in 2019 was largely due to the significant increase in PPI information requests (PIRs) leading up to the deadline for submission of claims on 29 August 2019, and also reflects costs relating to complaints received from the Official Receiver as well as administration costs. The Lloyds Banking Group has reached final agreement with the Official Receiver.

At 31 December 2019, a provision of £596 million remained unutilised relating to complaints and associated administration costs. Total cash payments were £759 million during the year ended 31 December 2019.

Sensitivities
The total amount provided for PPI represents the Group's best estimate of the likely future cost. A number of risks and uncertainties remain including processing the remaining PIRs and outstanding complaints. The cost could differ from the Group's estimates and the assumptions underpinning them, and could result in a further provision being required. These may also be impacted by any further regulatory changes and potential additional remediation arising from the continuous improvement of the Group's operational practices.

For every one per cent increase in PIR conversion rate on the stock as at the industry deadline, the Group would expect an additional charge of approximately £40 million.

Other provisions for legal actions and regulatory matters
In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints in connection with its past conduct and claims brought by or on behalf of current and former employees, customers, investors and other third parties and is subject to legal proceedings and other legal actions. Where significant, provisions are held against the costs expected to be incurred in relation to these matters and matters arising from related internal reviews. During the year ended 31 December 2019 the Group charged a further £254 million in respect of legal actions and other regulatory matters, and the unutilised balance at 31 December 2019 was £232 million (31 December 2018: £442 million). The most significant items are as follows.

29 Other provisions (continued)

Arrears handling related activities

The Group has provided an additional £176 million in the year ended 31 December 2019 for the costs of identifying and rectifying certain arrears management fees and activities, taking the total provided to date to £630 million. The Lloyds Banking Group has put in place a number of actions to improve its handling of customers in these areas and has made good progress in reimbursing arrears fees to impacted customers.

Packaged bank accounts

The Group had provided a total of £204 million up to 31 December 2019 in respect of complaints relating to alleged mis-selling of packaged bank accounts, with no further amounts provided during the year ended 31 December 2019. A number of risks and uncertainties remain, particularly with respect to future volumes.

HBOS Reading – customer review

The Group has now completed its compensation assessment for all 71 business customers within the customer review, with more than 98 per cent of these offers to individuals accepted. In total, more than £100 million in compensation has been offered to victims of the HBOS Reading fraud prior to the publication of Sir Ross Cranston's independent quality assurance review of the customer review, of which £94 million has so far been accepted, in addition to £9 million for ex-gratia payments and £6 million for the re-imbursements of legal fees. Sir Ross's review was concluded on 10 December 2019 and made a number of recommendations, including a re-assessment of direct and consequential losses by an independent panel. The Group has committed to implementing the review's recommendations in full. In addition, further ex gratia payments of £35,000 have been made to 200 individuals in recognition of the additional delay which will be caused whilst the Group takes steps to implement the review's recommendations. It is not possible to estimate at this stage what the financial impact will be.

HBOS Reading – FCA investigation

The FCA's investigation into the events surrounding the discovery of misconduct within the Reading-based Impaired Assets team of HBOS has concluded. The Lloyds Banking Group has settled the matter with the FCA and paid a fine of £45.5 million, as per the FCA's final notice dated 21 June 2019.

30 Subordinated liabilities

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

The Group	Preference shares[1] £m	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2018	–	326	4,611	2,112	7,049
Repurchases and redemptions during the year:[2]					
10.5% Subordinated Bonds callable 2018	–	–	–	(150)	(150)
Floating Rate Subordinated Notes callable 2018	–	–	–	(44)	(44)
	–	–	–	(194)	(194)
Foreign exchange movements	–	–	(13)	–	(13)
Other movements (all non-cash)	–	(5)	(2)	(60)	(67)
At 31 December 2018	–	321	4,596	1,858	6,775
Repurchases and redemptions during the year:[2]					
9.375% Subordinated Bonds 2021	–	–	–	**(328)**	**(328)**
6.375% Subordinated Instruments 2019	–	–	–	**(250)**	**(250)**
	–	–	–	**(578)**	**(578)**
Foreign exchange movements	**–**	**–**	**(24)**	**–**	**(24)**
Other movements (all non-cash)	**–**	**2**	**(1)**	**(73)**	**(72)**
At 31 December 2019	**–**	**323**	**4,571**	**1,207**	**6,101**

1 Since 2009, the Group has had in issue 400 6% non-cumulative preference shares of 25p each.

2 The repurchases and redemptions in the year resulted in cash outflows of £578 million (2018: £194 million).

30 Subordinated liabilities (continued)

The Bank	Preference shares[1] £m	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2018	–	175	4,762	2,112	7,049
Repurchases and redemptions during the year:[2]					
10.5% Subordinated Bonds callable 2018	–	–	–	(150)	(150)
Floating Rate Subordinated Notes callable 2018	–	–	–	(44)	(44)
	–	–	–	(194)	(194)
Foreign exchange movements	–	–	(13)	–	(13)
Other movements (all non-cash)	–	(5)	(2)	(60)	(67)
At 31 December 2018	–	170	4,747	1,858	6,775
Repurchases and redemptions during the year:[2]					
9.375% Subordinated Bonds 2021	**–**	**–**	**–**	**(328)**	**(328)**
6.375% Subordinated Instruments 2019	**–**	**–**	**–**	**(250)**	**(250)**
	–	**–**	**–**	**(578)**	**(578)**
Foreign exchange movements	**–**	**–**	**(24)**	**–**	**(24)**
Other movements (all non-cash)	**–**	**2**	**(1)**	**(73)**	**(72)**
At 31 December 2019	**–**	**172**	**4,722**	**1,207**	**6,101**

1 The Bank has in issue 400 6% non-cumulative preference shares of 25p each.

2 The repurchases and redemptions in the year resulted in cash outflows of £578 million (2018: £194 million).

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 (2018: none).

31 Share capital

(1) Authorised share capital	Group and Bank			
	2019 Number of shares	2018 Number of shares	**2019 £m**	2018 £m
Sterling				
Ordinary shares of 25p				
At 1 January and 31 December	**24,085,301,755**	24,085,301,755	**6,021**	6,021
8.117% non-cumulative perpetual preference shares class 'A' of £10 each	**250,000**	250,000	**3**	3
7.754% non-cumulative perpetual preference shares class 'B' of £10 each	**150,000**	150,000	**2**	2
			6,026	6,026

(2) Issue share capital	Group and Bank			
	2019 Number of shares	2018 Number of shares	**2019 £m**	2018 £m
Issued and fully paid ordinary shares				
Ordinary shares of 25p each				
At 1 January and 31 December	**23,388,340,552**	23,388,340,552	**5,847**	5,847
Issued and fully paid preference shares				
Preference shares of 25p each				
At 1 January and 31 December	**400**	400	**–**	–
Total share capital at 31 December	**23,388,340,952**	23,388,340,952	**5,847**	5,847

Share capital and control
There are no limitations on voting rights or restrictions on the transfer of shares in the Bank other than as set out in the articles of association, and certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws).

31 Share capital (continued)

Ordinary shares

The holders of ordinary shares, who held 100 per cent of the total ordinary share capital at 31 December 2019, are entitled to receive the Bank's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares may also receive a dividend (subject to the provisions of the Bank's articles of association) and on a winding up may share in the assets of the Bank.

32 Other reserves

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Other reserves comprise:				
Merger and other reserves[1]	**1,600**	1,600	**1,600**	1,600
Capital redemption reserve[1]	**482**	482	**482**	482
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**(7)**	(11)	**6**	2
Revaluation reserve in respect of equity shares held at fair value through other comprehensive income	**–**	–	**–**	–
Cash flow hedging reserve	**(41)**	(70)	**(41)**	(70)
Foreign currency translation reserve	**(15)**	(109)	**–**	131
At 31 December	**2,019**	1,892	**2,047**	2,145

1 There have been no movements in these reserves over 2018 or 2019.

Movements in other reserves were as follows:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income				
At 1 January	**(11)**	1	**2**	4
Change in fair value	**5**	3	**5**	11
Deferred tax	**(1)**	(3)	**(1)**	(1)
Current tax	**–**	–	**–**	–
	4	–	**4**	10
Income statement transfers:				
Disposals (note 8)	**–**	(16)	**–**	(16)
Deferred tax	**–**	4	**–**	4
Current tax	**–**	–	**–**	–
	–	(12)	**–**	(12)
At 31 December	**(7)**	(11)	**6**	2

32 Other reserves (continued)

Revaluation reserve in respect of equity shares held at fair value through other comprehensive income	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
At 1 January	–	(4)	–	3
Change in fair value	–	10	–	3
Deferred tax	–	–	–	–
Current tax	–	–	–	–
	–	10	–	3
Realised gains and losses transferred to retained profits				
Gross gains and losses	–	(6)	–	(6)
Deferred tax	–	–	–	–
Current tax	–	–	–	–
	–	(6)	–	(6)
At 31 December	–	–	–	–

	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Cash flow hedging reserve				
At 1 January	**(70)**	23	**(70)**	23
Change in fair value of hedging derivatives	**2**	(97)	**2**	(97)
Deferred tax	**(1)**	25	**(1)**	25
	1	(72)	**1**	(72)
Income statement transfers	**37**	(28)	**37**	(28)
Deferred tax	**(9)**	7	**(9)**	7
	28	(21)	**28**	(21)
At 31 December	**(41)**	(70)	**(41)**	(70)

	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Foreign currency translation reserve				
At 1 January	**(109)**	(113)	**131**	128
Currency translation differences arising in the year	**(17)**	4	**(8)**	3
Transfers to income statement (tax: £nil)	**111**	–	**(123)**	–
At 31 December	**(15)**	(109)	**–**	131

33 Retained profits

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
At 1 January	**2,373**	3,827	**1,860**	3,273
Profit for the year[1,2]	**674**	1,568	**749**	1,609
Dividends paid (note 35)	**(500)**	(3,000)	**(500)**	(3,000)
Distributions on other equity instruments[2]	**(101)**	(101)	**(101)**	(101)
Post-retirement defined benefit scheme remeasurements (net of tax)	**17**	–	**17**	–
Capital contribution received	**53**	73	**53**	73
Realised gains and losses on equity shares held at fair value through other comprehensive income	**–**	6	**–**	6
At 31 December	**2,516**	2,373	**2,078**	1,860

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

2 Restated, see note 1.

34 Other equity instruments

	The Group and Bank	
	2019 £m	2018 £m
At 1 January	**1,500**	1,500
Additional Tier 1 securities issued in the period	**1,200**	–
At 31 December	**2,700**	1,500

On 19 December 2019 the Bank issued £1,200,000,000 of Additional Tier 1 (AT1) securities to Lloyds Bank plc. This is in addition to the £1,500,000,000 of AT1 securities that the Bank issued to Lloyds Bank plc on 4 December 2015. The AT1 securities are Fixed Rate Resetting Perpetual Subordinated Permanent Write-Down Securities with no fixed maturity or redemption date.

The principal terms of the AT1 securities are described below:

- The securities rank behind the claims against the Bank of unsubordinated creditors on a Winding-Up.
- The securities bear a fixed rate of interest until the first call date. After the initial call date, in the event that they are not redeemed, the AT1 securities will bear interest at rates fixed periodically in advance for five year periods based on the then prevailing reference rate plus initial spread.
- Interest on the securities will be due and payable only at the sole discretion of the Bank and the Bank may at any time elect to cancel any Interest Payment (or any part thereof) which would otherwise be payable on any Interest Payment Date. There are also certain restrictions on the payment of interest as specified in the terms.
- The securities are undated and are repayable, at the option of the Bank, in whole at the first call date, or at any Interest Payment date thereafter. In addition, the AT1 securities are repayable, at the option of the Bank, in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the PRA.
- The securities will be subject to a Permanent Write Down should the fully Loaded Common Equity Tier 1 ratio of the Bank fall below 7.0 per cent.

35 Dividends on ordinary shares

Dividends paid in the year were as follows:

	2019 £m	2018 £m
Interim dividends	**500**	3,000

36 Share-based payments

During the year ended 31 December 2019 Lloyds Banking Group plc operated a number of share-based payment schemes for which employees of the Bank of Scotland 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 9), was £78 million (2018: £98 million).

During the year ended 31 December 2019 the Lloyds Banking Group operated the following share-based payment schemes, all of which are equity settled.

36 Share-based payments (continued)

Group Performance Share plan
The Group operates a Group Performance Share plan that is equity settled. Bonuses in respect of employee performance in 2019 have been recognised in the charge in line with the proportion of the deferral period completed.

Save-As-You-Earn schemes
Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £500 per month and, at the expiry of a fixed term of three 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:

	2019		2018	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**802,994,918**	**49.30**	860,867,088	51.34
Granted	**487,654,212**	**39.87**	188,866,162	47.92
Exercised	**(27,303,963)**	**51.23**	(135,721,404)	59.00
Forfeited	**(15,830,204)**	**48.69**	(22,909,999)	49.85
Cancelled	**(130,068,149)**	**49.03**	(78,073,042)	50.66
Expired	**(49,352,741)**	**58.74**	(10,033,887)	55.20
Outstanding at 31 December	**1,068,094,073**	**44.55**	802,994,918	49.30
Exercisable at 31 December	**227,139**	**60.70**	68,378	60.02

The weighted average share price at the time that the options were exercised during 2019 was £0.59 (2018: £0.67). The weighted average remaining contractual life of options outstanding at the end of the year was 2.22 years (2018: 2.16 years).

The weighted average fair value of SAYE options granted during 2019 was £0.10 (2018: £0.13). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

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 (to compensate new recruits for any lost share awards), and also to make grants to key individuals for retention purposes. In some instances, grants may be made subject to individual performance conditions.

Participants are not entitled to any dividends paid during the vesting period.

	2019		2018	
	Number of options	**Weighted average exercise price (pence)**	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**10,263,028**	**Nil**	14,523,989	Nil
Granted	**2,336,171**	**Nil**	3,914,599	Nil
Exercised	**(4,455,481)**	**Nil**	(6,854,043)	Nil
Vested	**(69,005)**	**Nil**	(148,109)	Nil
Forfeited	**(39,250)**	**Nil**	(662,985)	Nil
Lapsed	**(400,825)**	**Nil**	(510,423)	Nil
Outstanding at 31 December	**7,634,638**	**Nil**	10,263,028	Nil
Exercisable at 31 December	**2,683,267**	**Nil**	3,305,442	Nil

The weighted average fair value of options granted in the year was £0.59 (2018: £0.55). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2019 was £0.60 (2018: £0.65). The weighted average remaining contractual life of options outstanding at the end of the year was 3.8 years (2018: 5.2 years).

36 Share-based payments (continued)

Other share plans
Lloyds Banking Group Executive Share Ownership Plan
The plan, 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.

At the end of the performance period for the 2016 grant, the targets had not been fully met and therefore these awards vested in 2019 at a rate of 68.7 per cent.

	2019 Number of shares	2018 Number of shares
Outstanding at 1 January	**417,385,636**	370,804,915
Granted	**174,490,843**	160,586,201
Vested	**(88,318,950)**	(73,270,301)
Forfeited	**(55,029,439)**	(48,108,870)
Dividend award	**11,376,655**	7,373,691
Outstanding at 31 December	**459,904,745**	417,385,636

Awards in respect of the 2017 grant vested in 2020 at a rate of 49.7 per cent. For the 2017 grant, participants are entitled to any dividends paid during the vesting period. An amount equal in value to any dividends paid between the award date and the date the Remuneration Committee determine that the performance conditions were met, will be paid, based on the number of shares that vest. The Remuneration Committee can determine if any dividends are to be paid in cash or in shares. Details of the performance conditions for the plan are provided in the Directors' remuneration report.

The weighted average fair value of awards granted in the year was £0.45 (2018: £0.48).

CFO Buyout
William Chalmers joined the Group on 3 June 2019 and was appointed as Chief Financial Officer on 1 August 2019 on the retirement of George Culmer. He was granted deferred share awards over 4,086,632 shares, to replace unvested awards from his former employer, Morgan Stanley, that were forfeited as a result of him joining the Group.

	2019 Number of shares
Outstanding at 1 January	–
Granted	**4,086,632**
Exercised	**(818,172)**
Outstanding at 31 December	**3,268,460**

The weighted average fair value of awards granted in the year was £0.55.

The fair value calculations at 31 December 2019 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Save-As-You-Earn	**Executive Share Plan 2003**	**LTIP**	**CFO Buyout**
Weighted average risk-free interest rate	**0.36%**	**0.62%**	**0.83%**	**0.64%**
Weighted average expected life	**3.2 years**	**1.3 years**	**3.7 years**	**1.4 years**
Weighted average expected volatility	**20%**	**23%**	**27%**	**19%**
Weighted average expected dividend yield	**4.0%**	**4.0%**	**4.0%**	**4.0%**
Weighted average share price	**£0.53**	**£0.62**	**£0.63**	**£0.58**
Weighted average exercise price	**£0.40**	**Nil**	**Nil**	**Nil**

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 up to a maximum of £3,600. 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.

On 9 May 2019, the Group made an award of £200 (2018: £200) of shares to all eligible employees. The number of shares awarded was 22,422,337 (2018: 21,513,300), with an average fair value of £0.62 (2018: £0.67) based on the market price at the date of award.

36 Share-based payments (continued)

Matching shares
The Group undertakes to match shares purchased by employees up to the value of £45 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, all 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 2019 was 37,346,812 (2018: 34,174,161), with an average fair value of £0.56 (2018: £0.63), based on market prices at the date of award.

Fixed share awards
Fixed share awards were introduced in 2014 in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for certain Lloyds Banking Group employees, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The fixed share awards are delivered in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award. The number of shares purchased in 2019 was 8,239,332 (2018: 8,965,562).

The fixed share award is not subject to any performance conditions, performance adjustment or clawback. On an employee leaving the Group, there is no change to the timeline for which shares will become unrestricted.

37 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.

The table below details, on an aggregated basis, key management personnel compensation which has been allocated to the Bank on an estimated basis.

	2019 £m	2018 £m
Compensation		
Salaries and other short-term benefits	**6**	6
Share-based payments	**6**	7
Total compensation	**12**	13

The aggregate of the emoluments of the directors was £4.7 million (2018: £4.9 million).

Aggregate company contributions in respect of directors to defined contribution pension schemes were £nil (2018: £nil).

The total for the highest paid director (António Horta-Osório) was £1,631,000 (2018: (António Horta-Osório) £2,189,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in either year.

	2019 million	2018 million
Share options over Lloyds Banking Group plc shares		
At 1 January	**–**	1
Exercised/lapsed (includes entitlements of former key management personnel)	**–**	(1)
At 31 December	**–**	–

	2019 million	2018 million
Share incentive plans settled in Lloyds Banking Group plc shares		
At 1 January	**84**	82
Granted (includes entitlements of appointed key management personnel)	**46**	39
Exercised/lapsed (includes entitlements of former key management personnel)	**(29)**	(37)
At 31 December	**101**	84

37 Related party transactions (continued)

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

	2019 £m	2018 £m
Loans		
At 1 January	**2**	2
Advanced (includes loans of appointed key management personnel)	**1**	1
Repayments (includes loans of former key management personnel)	**(1)**	(1)
At 31 December	**2**	2

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 6.45 per cent and 24.2 per cent in 2019 (6.70 per cent and 24.20 per cent in 2018).

No provisions have been recognised in respect of loans given to key management personnel (2018: nil).

	2019 £m	2018 £m
Deposits		
At 1 January	**20**	20
Placed (includes deposits of appointed key management personnel)	**44**	33
Withdrawn (includes deposits of former key management personnel)	**(41)**	(33)
At 31 December	**23**	20

Deposits placed by key management personnel attracted interest rates of up to 3 per cent in 2019 (2018: 3.5 per cent).

At 31 December 2019, the Group did not provide any guarantees in respect of key management personnel (2018 none).

At 31 December 2019, transactions, arrangements and agreements entered into by the Lloyds Banking Group's banking subsidiaries with directors and connected persons of the Group included amounts outstanding in respect of loans and credit card transactions of £0.6 million with 5 directors and 2 connected persons (2018: £0.5 million with three directors and three connected persons).

Balances and transactions with fellow Lloyds Banking Group undertakings

Transfers of operations

During the year, the Bank transferred the majority of its Netherlands and Germany business to Lloyds Bank Gmbh, a fellow Lloyds Banking Group undertaking.

Balances and transactions between members of the Bank of Scotland Group

In accordance with IFRS10 *Consolidated financial statements*, 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:

	2019 £m	2018 £m
Assets, included within:		
Due from fellow Lloyds Banking Group undertakings	**11,490**	11,085
Liabilities, included within:		
Due to fellow Lloyds Banking Group undertakings	**8,285**	7,920
Debt securities in issue	**4,066**	2,999
Subordinated liabilities	**151**	151
	12,502	11,070

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 2019 the Bank earned interest income on the above asset balances of £172 million (2018: £141 million, adjusted to align with balance sheet presentation) and incurred interest expense on the above liability balances of £166 million (2018: £128 million, adjusted to align with balance sheet presentation).

37 Related party transactions (continued)

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

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Assets, included within:				
Derivative financial instruments	**7,026**	6,201	**7,026**	6,201
Due from fellow Lloyds Banking Group undertakings	**97,534**	58,932	**97,445**	58,830
	104,560	65,133	**104,471**	65,031

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Liabilities, included within:				
Due to fellow Lloyds Banking Group undertakings	**161,618**	111,769	**161,528**	111,680
Derivative financial instruments	**9,107**	8,014	**9,107**	8,014
Subordinated liabilities	**5,502**	5,534	**5,502**	5,534
Debt securities in issue	**45**	61	**5**	6
	176,272	125,378	**176,142**	125,234

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 2019 the Group earned £613 million and the Bank earned £613 million of interest income on the above asset balances (2018: £428 million for the Group and £428 million for the Bank); the Group incurred £2,252 million and the Bank incurred £2,250 million of interest expense on the above liability balances (2018: £2,159 million for the Group and £2,157 million for the Bank).

During the year, the Group disposed of certain entities to fellow subsidiaries of Lloyds Banking Group plc. The ultimate controlling party of these entities remained the same following the transfer.

Other related party disclosures
Pension funds
At 31 December 2019 there were customer deposits of £50 million (2018: £48 million) related to the HBOS Group's pension arrangements.

Joint ventures and associates
At 31 December 2019 there were loans and advances to customers of £67 million (2018: £57 million) outstanding and balances within customer deposits of £3 million (2018: £2 million) relating to joint ventures and associates.

38 Contingent liabilities, commitments and guarantees

Interchange fees
With respect to multi-lateral interchange fees (MIFs), the Lloyds Banking Group is not involved in the ongoing litigation (as described below) which involves card schemes such as Visa and Mastercard. However, the Lloyds Banking Group is a member/licensee of Visa and Mastercard and other card schemes. The litigation in question is as follows:

- litigation brought by retailers against both Visa and Mastercard continues in the English Courts (and includes appeals heard by the Supreme Court, judgment awaited); and
- litigation brought on behalf of UK consumers in the English Courts against Mastercard.

Any impact on the Lloyds Banking Group of the litigation against Visa and Mastercard remains uncertain at this time. Insofar as Visa is required to pay damages to retailers for interchange fees set prior to June 2016, contractual arrangements to allocate liability have been agreed between various UK banks (including the Lloyds Banking Group) and Visa Inc, as part of Visa Inc's acquisition of Visa Europe in 2016. These arrangements cap the maximum amount of liability to which the Lloyds Banking Group may be subject, and this cap is set at the cash consideration received by the Lloyds Banking Group for the sale of its stake in Visa Europe to Visa Inc in 2016.

LIBOR and other trading rates
In July 2014, the Lloyds Banking Group announced that it had reached settlements totalling £217 million (at 30 June 2014 exchange rates) to resolve with UK and US federal authorities legacy issues regarding the manipulation several years ago of Lloyds Banking Group companies' submissions to the British Bankers' Association (BBA) London Interbank Offered Rate (LIBOR) and Sterling Repo Rate. The Swiss Competition Commission concluded its investigation against Lloyds Bank plc in June 2019. The Lloyds Banking Group continues to cooperate with various other government and regulatory authorities, including a number of US State Attorneys General, in conjunction with their investigations into submissions made by panel members to the bodies that set LIBOR and various other interbank offered rates.

Certain Lloyds Banking Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling LIBOR and the Australian BBSW Reference Rate. Certain of the plaintiffs' claims have been dismissed by the US Federal Court for Southern District of New York (subject to appeals).

38 Contingent liabilities, commitments and guarantees (continued)

Certain Lloyds Banking Group companies are also named as defendants in (i) UK based claims; and (ii) two Dutch class actions, raising LIBOR manipulation allegations. A number of the claims against the Lloyds Banking Group in relation to the alleged mis-sale of interest rate hedging products also include allegations of LIBOR manipulation.

It is currently not possible to predict the scope and ultimate outcome on the Lloyds Banking Group of the various outstanding regulatory investigations not encompassed by the settlements, any private lawsuits or any related challenges to the interpretation or validity of any of the Lloyds Banking Group's contractual arrangements, including their timing and scale.

Tax authorities
The Lloyds Banking Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Lloyds Banking Group that their interpretation of the UK rules which allow the offset of such losses denies the claim for group relief of losses. If HMRC's position is found to be correct, management estimate that this would result in an increase in current tax liabilities of approximately £175 million (including interest). The Lloyds Banking Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

Mortgage arrears handling activities – FCA investigation
On 26 May 2016, the Lloyds Banking Group was informed that an enforcement team at the FCA had commenced an investigation in connection with the Lloyds Banking Group's mortgage arrears handling activities. It is not currently possible to make a reliable assessment of any liability resulting from the investigation including any financial penalty.

Other legal actions and regulatory matters
In addition, during the ordinary course of business the Group is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations 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 at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

Contingent liabilities, commitments and guarantees arising from the banking business

	The Group		**The Bank**	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Contingent liabilities				
Acceptances and endorsements	**1**	1	**1**	1
Other:				
Other items serving as direct credit substitutes	**20**	36	**20**	36
Performance bonds and other transaction-related contingencies	**199**	192	**199**	192
	219	228	**219**	228
Total contingent liabilities	**220**	229	**220**	229

38 Contingent liabilities, commitments and guarantees (continued)

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

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Commitments and guarantees				
Documentary credits and other short-term trade-related transactions	**–**	1	**–**	1
Forward asset purchases and forward deposits placed	**14**	47	**14**	47
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year original maturity:				
Mortgage offers made	**11,271**	10,059	**11,143**	9,497
Other commitments and guarantees	**24,217**	23,024	**24,176**	22,982
	35,488	33,083	**35,319**	32,479
1 year or over original maturity	**2,410**	3,211	**2,410**	3,210
Total commitments and guarantees	**37,912**	36,342	**37,743**	35,737

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £14,478 million (2018: £13,937 million) for the Group and £14,383 million (2018: £13,021 million) for the Bank were irrevocable.

Capital commitments

Excluding commitments of the Group in respect of investment property (note 21), there was no capital expenditure contracted but not provided for at 31 December 2019 (2018: £nil).

39 Structured entities

The Group's interests in structured entities are consolidated. Details of the Group's interest in consolidated structured entities are set out in note 26 for securitisations and covered bond vehicles.

40 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 table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

The Group	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	Designated at fair value through profit or loss £m	At fair value through other comprehensive income £m	Held at amortised cost £m	Total £m
At 31 December 2019							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	2,492	2,492
Items in the course of collection from banks	–	–	–	–	–	40	40
Financial assets at fair value through profit or loss	–	–	463	–	–	–	463
Derivative financial instruments	1,523	8,815	–	–	–	–	10,338
Loans and advances to banks	–	–	–	–	–	311	311
Loans and advances to customers	–	–	–	–	–	258,315	258,315
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	97,534	97,534
Financial assets at amortised cost	–	–	–	–	–	356,160	356,160
Financial assets at fair value through other comprehensive income	–	–	–	–	2,253	–	2,253
Total financial assets	1,523	8,815	463	–	2,253	358,692	371,746
Financial liabilities							
Deposits from banks	–	–	–	–	–	16,472	16,472
Customer deposits	–	–	–	–	–	151,845	151,845
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	161,618	161,618
Items in course of transmission to banks	–	–	–	–	–	143	143
Financial liabilities at fair value through profit or loss	–	–	–	47	–	–	47
Derivative financial instruments	996	10,356	–	–	–	–	11,352
Notes in circulation	–	–	–	–	–	1,079	1,079
Debt securities in issue	–	–	–	–	–	11,204	11,204
Other liabilities	–	–	–	–	–	770	770
Subordinated liabilities	–	–	–	–	–	6,101	6,101
Total financial liabilities	996	10,356	–	47	–	349,232	360,631

40 Financial instruments (continued)

The Group	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss		Designated at fair value through profit or loss £m	At fair value through other comprehensive income £m	Held at amortised cost £m	Total £m
		Held for trading £m	Other £m				
At 31 December 2018							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	2,579	2,579
Items in the course of collection from banks	–	–	–	–	–	181	181
Financial assets at fair value through profit or loss	–	–	509	–	–	–	509
Derivative financial instruments	2,381	6,980	–	–	–	–	9,361
Loans and advances to banks	–	–	–	–	–	471	471
Loans and advances to customers	–	–	–	–	–	262,324	262,324
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	58,932	58,932
Financial assets at amortised cost	–	–	–	–	–	321,727	321,727
Financial assets at fair value through other comprehensive income	–	–	–	–	968	–	968
Total financial assets	2,381	6,980	509	–	968	324,487	335,325
Financial liabilities							
Deposits from banks	–	–	–	–	–	20,908	20,908
Customer deposits	–	–	–	–	–	162,141	162,141
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	111,769	111,769
Items in course of transmission to banks	–	–	–	–	–	274	274
Financial liabilities at fair value through profit or loss	–	50	–	53	–	–	103
Derivative financial instruments	1,546	8,662	–	–	–	–	10,208
Notes in circulation	–	–	–	–	–	1,104	1,104
Debt securities in issue	–	–	–	–	–	11,861	11,861
Subordinated liabilities	–	–	–	–	–	6,775	6,775
Total financial liabilities	1,546	8,712	–	53	–	314,832	325,143

40 Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	Designated at fair value through profit or loss £m	At fair value through other comprehensive income £m	Held at amortised cost £m	Total £m
At 31 December 2019							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	2,492	2,492
Items in the course of collection from banks	–	–	–	–	–	40	40
Financial assets at fair value through profit or loss	–	–	117	–	–	–	117
Derivative financial instruments	1,523	8,773	–	–	–	–	10,296
Loans and advances to banks	–	–	–	–	–	307	307
Loans and advances to customers	–	–	–	–	–	252,931	252,931
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	108,935	108,935
Financial assets at amortised cost	–	–	–	–	–	362,173	362,173
Financial assets at fair value through other comprehensive income	–	–	–	–	2,253	–	2,253
Total financial assets	1,523	8,773	117	–	2,253	364,705	377,371
Financial liabilities							
Deposits from banks	–	–	–	–	–	16,472	16,472
Customer deposits	–	–	–	–	–	151,818	151,818
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	169,813	169,813
Items in course of transmission to banks	–	–	–	–	–	143	143
Derivative financial instruments	996	10,052	–	–	–	–	11,048
Notes in circulation	–	–	–	–	–	1,079	1,079
Debt securities in issue	–	–	–	–	–	9,700	9,700
Other liabilities	–	–	–	–	–	770	770
Subordinated liabilities	–	–	–	–	–	6,101	6,101
Total financial liabilities	996	10,052	–	–	–	355,896	366,944

40 Financial instruments (continued)

The Bank	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	Designated at fair value through profit or loss £m	At fair value through other comprehensive income £m	Held at amortised cost £m	Total £m
At 31 December 2018							
Financial assets							
Cash and balances at central banks	–	–	–	–	–	2,579	2,579
Items in the course of collection from banks	–	–	–	–	–	181	181
Financial assets at fair value through profit or loss	–	–	110	–	–	–	110
Derivative financial instruments	2,381	6,844	–	–	–	–	9,225
Loans and advances to banks	–	–	–	–	–	471	471
Loans and advances to customers	–	–	–	–	–	256,990	256,990
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	69,915	69,915
Financial assets at amortised cost	–	–	–	–	–	327,376	327,376
Financial assets at fair value through other comprehensive income	–	–	–	–	968	–	968
Total financial assets	2,381	6,844	110	–	968	330,136	340,439
Financial liabilities							
Deposits from banks	–	–	–	–	–	20,908	20,908
Customer deposits	–	–	–	–	–	162,141	162,141
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	119,600	119,600
Items in course of transmission to banks	–	–	–	–	–	274	274
Financial liabilities at fair value through profit or loss	–	50	–	–	–	–	50
Derivative financial instruments	1,546	8,318	–	–	–	–	9,864
Notes in circulation	–	–	–	–	–	1,104	1,104
Debt securities in issue	–	–	–	–	–	10,184	10,184
Subordinated liabilities	–	–	–	–	–	6,775	6,775
Total financial liabilities	1,546	8,368	–	–	–	319,882	329,796

40 Financial instruments (continued)

(2) Fair value measurement
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is a measure as at a specific date and may be significantly different from the amount which will actually be paid or received on maturity or settlement date.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted 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. The Group measures valuation adjustments for its derivative exposures on the same basis as derivatives are managed.

The carrying amount of the following financial instruments is a reasonable approximation of fair value: cash and balances at central banks, items in the course of collection from banks, items in course of transmission to banks and notes in circulation.

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 are not financial instruments or for other assets and liabilities which are not carried at fair value in the Group's consolidated balance sheet. 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.

Valuation of financial assets and liabilities
Assets and liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values.

Level 1
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
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
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.

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.

40 Financial instruments (continued)

(3) Financial assets and liabilities carried at fair value
(A) Financial assets, excluding derivatives
Valuation hierarchy
At 31 December 2019 the Group's financial assets carried at fair value, excluding derivatives, totalled £2,716 million (31 December 2018: £1,477 million); and for the Bank totalled £2,370 million (31 December 2018: £1,078 million). The tables below analyse these financial assets by balance sheet classification, asset type and valuation methodology (level 1, 2 or 3, as described on page 89). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

Valuation hierarchy

The Group At 31 December 2019	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets at fair value through profit or loss				
Loans and advances to customers	**–**	**–**	**463**	**463**
Total financial assets at fair value through profit or loss	**–**	**–**	**463**	**463**
Financial assets at fair value through other comprehensive income				
Corporate and other debt securities	**–**	**2,253**	**–**	**2,253**
Total financial assets at fair value through other comprehensive income	**–**	**2,253**	**–**	**2,253**
Total financial assets carried at fair value, excluding derivatives	**–**	**2,253**	**463**	**2,716**

The Group At 31 December 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	399	110	509
Total financial assets at fair value through profit or loss	–	399	110	509
Financial assets at fair value through other comprehensive income				
Corporate and other debt securities	–	968	–	968
Total financial assets at fair value through other comprehensive income	–	968	–	968
Total financial assets carried at fair value, excluding derivatives	–	1,367	110	1,477

40 Financial instruments (continued)

Valuation hierarchy

The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
At 31 December 2019				
Financial assets at fair value through profit or loss				
Loans and advances to customers	**–**	**–**	**117**	**117**
Total financial assets at fair value through profit or loss	**–**	**–**	**117**	**117**
Financial assets at fair value through other comprehensive income				
Corporate and other debt securities	**–**	**2,253**	**–**	**2,253**
Total financial assets at fair value through other comprehensive income	**–**	**2,253**	**–**	**2,253**
Total financial assets carried at fair value, excluding derivatives	**–**	**2,253**	**117**	**2,370**

Valuation hierarchy

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2018				
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	–	110	110
Total financial assets at fair value through profit or loss	–	–	110	110
Financial assets at fair value through other comprehensive income				
Corporate and other debt securities	–	968	–	968
Total financial assets at fair value through other comprehensive income	–	968	–	968
Total financial assets carried at fair value, excluding derivatives	–	968	110	1,078

40 Financial instruments (continued)

Movements in level 3 portfolio

The table below analyses movements in level 3 financial assets, excluding derivatives, carried at fair value (recurring measurement):

The Group	2019			2018		
	Financial assets at fair value through profit or loss £m	At fair value through other comprehensive income £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m	Financial assets at fair value through profit or loss £m	At fair value through other comprehensive income £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m
At 1 January	110	–	110	63	7	70
Exchange and other adjustments	–	–	–	1	–	1
Gains (losses) recognised in the income statement within other income	3	–	3	(1)	–	(1)
Losses recognised in other comprehensive income within the revaluation reserve in respect of financial assets at fair value through other comprehensive income	–	–	–	–	(5)	(5)
Purchases	–	–	–	18	–	18
Sales	(57)	–	(57)	(67)	(128)	(195)
Transfers into the level 3 portfolio	407	–	407	96	126	222
At 31 December	463	–	463	110	–	110
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	–	–	–	–	–	–

The Bank	2019			2018		
	Financial assets at fair value through profit or loss £m	At fair value through other comprehensive income £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m	Financial assets at fair value through profit or loss £m	At fair value through other comprehensive income £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m
At 1 January	110	–	110	–	7	7
Gains (losses) recognised in the income statement within other income	3	–	3	(4)	–	(4)
Losses recognised in other comprehensive income within the revaluation reserve in respect of financial assets at fair value through other comprehensive income	–	–	–	–	(5)	(5)
Purchases	–	–	–	18	–	18
Sales	(4)	–	(4)	–	(128)	(128)
Transfers into the level 3 portfolio	8	–	8	96	126	222
At 31 December	117	–	117	110	–	110
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	–	–	–	–	–	–

40 Financial instruments (continued)

Valuation methodology for financial assets, excluding derivatives

Loans and advances to customers and banks
The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from market observable interest rates, a risk margin that reflects loan credit ratings and an incremental illiquidity premium based on historical spreads at origination on similar loans.

Debt securities
Debt securities measured at fair value and classified as level 2 are valued by discounting expected cash flows using an observable credit spread applicable to the particular instrument.

Where there is limited trading activity in debt securities, the Group uses valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes to determine an appropriate valuation. Debt securities are classified as level 3 if there is a significant valuation input that cannot be corroborated through market sources or where there are materially inconsistent values for an input. Asset classes classified as level 3 mainly comprise certain collateralised loan obligations and collateralised debt obligations.

Equity investments
Unlisted equity and fund investments are valued using different techniques in accordance with the Group's valuation policy and 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.

Unlisted equity investments and investments in property partnerships held in the life assurance funds are valued using third party valuations. 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.

(B) Financial liabilities, excluding derivatives
Valuation hierarchy
At 31 December 2019, the Group's financial liabilities carried at fair value, excluding derivatives, comprised its trading and other financial liabilities at fair value through profit or loss and totalled £47 million (31 December 2018: £103 million); and for the Bank totalled £nil (31 December 2018: £50 million) (Financial guarantees are also recognised at fair value, on initial recognition, and are classified as level 3; but the balance is not material). The tables below analyse these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 89). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2019				
Financial liabilities designated at fair value through profit or loss	**–**	**–**	**47**	**47**
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**–**	**–**	**–**	**–**
Other deposits	**–**	**–**	**–**	**–**
	–	**–**	**–**	**–**
Total financial liabilities carried at fair value, excluding derivatives	**–**	**–**	**47**	**47**
At 31 December 2018				
Financial liabilities designated at fair value through profit or loss	–	53	–	53
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	–	–	–
Other deposits	–	50	–	50
	–	50	–	50
Total financial liabilities carried at fair value, excluding derivatives	–	103	–	103

40 Financial instruments (continued)

The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
At 31 December 2019				
Other deposits	**–**	**–**	**–**	**–**
Total trading liabilities	**–**	**–**	**–**	**–**
Total financial liabilities carried at fair value, excluding derivatives	**–**	**–**	**–**	**–**
At 31 December 2018				
Other deposits	–	50	–	50
Total trading liabilities	–	50	–	50
Total financial liabilities carried at fair value, excluding derivatives	–	50	–	50

The table below analyses movements in level 3 financial liabilities, excluding derivatives:

The Group	**Trading and other financial liabilities at fair value through profit and loss £m**
At 1 January 2019	–
Losses recognised in the income statement within other income	1
Redemptions	(5)
Transfers into the level 3 portfolio	51
At 31 December 2019	**47**
Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December 2019	**–**

Valuation methodology for financial liabilities, excluding derivatives

Trading liabilities in respect of securities sold under repurchase agreements

The fair value of these liabilities is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security sold under the repurchase agreement.

40 Financial instruments (continued)

(C) Derivatives

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2019, such assets totalled £10,338 million for the Group and £10,296 million for the Bank (31 December 2018: £9,361 million for the Group and £9,225 million for the Bank) and liabilities totalled £11,352 million for the Group and £11,048 million for the Bank (31 December 2018: £10,208 million for the Group and £9,864 million for the Bank). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 89). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2019				
Derivative assets	**–**	**10,338**	**–**	**10,338**
Derivative liabilities	**–**	**(11,055)**	**(297)**	**(11,352)**
At 31 December 2018				
Derivative assets	–	9,361	–	9,361
Derivative liabilities	–	(10,208)	–	(10,208)

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2019				
Derivative assets	**–**	**10,296**	**–**	**10,296**
Derivative liabilities	**–**	**(11,048)**	**–**	**(11,048)**
At 31 December 2018				
Derivative assets	–	9,225	–	9,225
Derivative liabilities	–	(9,864)	–	(9,864)

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 which 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.

Certain unobservable inputs used to calculate CVA, FVA, and own credit adjustments, are not significant in determining the classification of the derivative and debt instruments. Consequently these inputs do not form part of the Level 3 sensitivities presented.

40 Financial instruments (continued)

The table below analyses movements in level 3 derivative assets and liabilities carried at fair value.

	The Group		The Bank	
	Derivative assets £m	Derivative liabilities £m	Derivative assets £m	Derivative liabilities £m
At 1 January 2018	420	(54)	420	(54)
Exchange and other adjustments	4	–	4	–
(Losses) gains recognised in the income statement within other income	(14)	6	(14)	6
(Sales) redemptions	(410)	48	(410)	48
At 31 December 2018	–	–	–	–
Redemptions	–	**47**	–	–
Transfers into the level 3 portfolio	–	**(344)**	–	–
At 31 December 2019	–	**(297)**	–	–
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December 2019	–	–	–	–
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December 2018	–	–	–	–

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 for the Group during 2019 and 2018.

	2019 £m	2018 £m
At 1 January	**140**	183
Income statement charge (credit)	**(36)**	(36)
Transfers	**(2)**	(7)
At 31 December	**102**	140

Represented by:

	2019 £m	2018 £m
Credit Valuation Adjustment	**73**	106
Debit Valuation Adjustment	**(2)**	(5)
Funding Valuation Adjustment	**31**	39
	102	140

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.

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.

40 Financial instruments (continued)

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.

The combination of a one notch deterioration in the credit rating of derivative counterparties and a ten per cent increase in LGD increases the CVA by £19 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. Where appropriate, the CVA for these products is calculated on an add-on basis (although no such adjustment was required at 31 December 2019).

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 £6 million to £8 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 £25 million fall in the overall valuation adjustment to £46 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 uncollateralised derivative positions. 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 £5 million.

(ii) 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 2019, the Group's derivative trading business held mid to bid-offer valuation adjustments of £4 million (2018: £3 million).

40 Financial instruments (continued)

(D) Sensitivity of level 3 valuations
Level 3 portfolio

			At 31 December 2019			At 31 December 2018		
				Effect of reasonably possible alternative assumptions[2]			Effect of reasonably possible alternative assumptions[2]	
	Valuation basis/ techniques	Significant unobservable inputs[1]	Carrying value £m	Favourable changes £m	Unfavourable changes £m	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Financial assets at fair value through profit or loss:								
Loans and advances to customers	Discounted cash flows	Interest rate spreads (bps) (50bps/102bps)	**463**	**22**	**(22)**	110	1	(1)
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**–**	**–**	**–**	–	–	–
			463			110		
Financial assets at fair value through other comprehensive income								
Equity and venture capital investments	Underlying asset/ net asset value (incl. property prices)[3]	n/a	**–**	**–**	**–**	–	–	–
			–			–		
Derivative financial assets								
Interest rate derivatives	Option pricing model	n/a	**–**	**–**	**–**	–	–	–
			–			–		
Level 3 financial assets carried at fair value			**463**			110		
Financial liabilities at fair value through profit or loss	Discounted cash flows	Interest rate spreads (+/- 50bps)	**47**	**1**	**(1)**	–	–	–
Derivative financial liabilities								
Interest rate derivaties	Market values – property valuation	HPI (+/- 50bps)	**297**	**17**	**(17)**	–	–	–
			297			–		
Level 3 financial liabilities carried at fair value			**344**			–		

1 Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.

2 Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

3 Underlying asset/net asset values represent fair value.

Unobservable inputs
Significant unobservable inputs affecting the valuation of debt securities, unlisted equity investments and derivatives are as follows:

- Interest rates and inflation rates are referenced in some derivatives where the payoff that the holder of the derivative receives depends on the behaviour of those underlying references through time.
- Credit spreads represent the premium above the benchmark reference instrument required to compensate for lower credit quality; higher spreads lead to a lower fair value.
- Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes.
- Earnings multiples are used to value certain unlisted equity investments; a higher earnings multiple will result in a higher fair value.

Reasonably possible alternative assumptions
Valuation techniques applied to many of the Group's level 3 instruments often involve the use of two or more inputs whose relationship is interdependent. The calculation of the effect of reasonably possible alternative assumptions included in the table above reflects such relationships.

Debt securities
Reasonably possible alternative assumptions have been determined in respect of the Group's structured credit investment by flexing credit spreads.

40 Financial instruments (continued)

Derivatives
Reasonably possible alternative assumptions have been determined in respect of swaptions in the Group's derivative portfolios which are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities were flexed within a range.

Unlisted equity, venture capital investments and investments in property partnerships
The valuation techniques used for unlisted equity and venture capital investments vary depending on the nature of the investment. Reasonably possible alternative valuations for these investments have been calculated by reference to the 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.

(4) Financial assets and liabilities carried at amortised cost

(A) Financial assets
Valuation hierarchy
The table below analyses the fair values of the financial assets of the Group and the Bank which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 89). Loans and receivables are mainly classified as level 3 due to significant unobservable inputs used in the valuation models where inputs are observable debt securities are classified as level 1 or 2.

			Valuation hierarchy		
The Group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2019					
Loans and advances to customers	**258,315**	**261,438**	**–**	**–**	**261,438**
Loans and advances to banks	**311**	**311**	**–**	**–**	**311**
Due from fellow Lloyds Banking Group undertakings	**97,534**	**97,534**	**–**	**–**	**97,534**
At 31 December 2018					
Loans and advances to customers	262,324	264,320	–	–	264,320
Loans and advances to banks	471	471	–	–	471
Due from fellow Lloyds Banking Group undertakings	58,932	58,932	–	–	58,932

40 Financial instruments (continued)

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2019					
Loans and advances to customers	**252,931**	**255,930**	**–**	**–**	**255,930**
Loans and advances to banks	**307**	**307**	**–**	**–**	**307**
Due from fellow Lloyds Banking Group undertakings	**108,935**	**108,935**	**–**	**–**	**108,935**
At 31 December 2018					
Loans and advances to customers	256,990	258,929	–	–	258,929
Loans and advances to banks	471	471	–	–	471
Due from fellow Lloyds Banking Group undertakings	69,915	69,915	–	–	69,915

Valuation methodology

Loans and advances to customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. Due to their short term nature, the carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value.

To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is usually 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. 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 value of commercial 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.

Loans and advances to banks

The carrying value of short dated loans and advances to banks is assumed to be their fair value. The fair value of loans and advances to banks is estimated by discounting the anticipated cash flows at a market discount rate adjusted for the credit spread of the obligor or, where not observable, the credit spread of borrowers of similar credit quality.

Debt securities

The fair values of debt securities, which were previously within assets held for trading and were reclassified to loans and receivables, 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.

Reverse repurchase agreements

The carrying amount is deemed a reasonable approximation of fair value given the short-term nature of these instruments.

40 Financial instruments (continued)

(B) Financial liabilities

Valuation hierarchy

The table below analyses the fair values of the financial liabilities of the Group and the Bank which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 89).

			Valuation hierarchy		
The Group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2019					
Deposits from banks	**16,472**	**16,472**	**–**	**16,472**	**–**
Customer deposits	**151,845**	**152,038**	**–**	**152,012**	**26**
Due to fellow Lloyds Banking Group undertakings	**161,618**	**161,618**	**–**	**161,618**	**–**
Debt securities in issue	**11,204**	**11,146**	**–**	**11,146**	**–**
Subordinated liabilities	**6,101**	**6,133**	**–**	**6,133**	**–**
Repos included in above amounts:					
Deposits from banks	**15,460**	**15,460**	**–**	**15,460**	**–**
At 31 December 2018					
Deposits from banks	20,908	20,908	–	20,908	–
Customer deposits	162,141	161,908	–	155,741	6,167
Due to fellow Lloyds Banking Group undertakings	111,769	111,769	–	111,769	–
Debt securities in issue	11,861	11,821	–	11,821	–
Subordinated liabilities	6,775	6,784	–	6,784	–
Repos included in above amounts:					
Deposits from banks	19,977	19,977	–	19,977	–

			Valuation hierarchy		
The Bank	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
At 31 December 2019					
Deposits from banks	**16,472**	**16,472**	**–**	**16,472**	**–**
Customer deposits	**151,818**	**152,011**	**–**	**152,011**	**–**
Due to fellow Lloyds Banking Group undertakings	**169,813**	**169,813**	**–**	**169,813**	**–**
Debt securities in issue	**9,700**	**9,683**	**–**	**9,683**	**–**
Subordinated liabilities	**6,101**	**6,133**	**–**	**6,133**	**–**
Repos included in above amounts:					
Deposits from banks	**15,460**	**15,460**	**–**	**15,460**	**–**
At 31 December 2018					
Deposits from banks	20,908	20,908	–	20,908	–
Customer deposits	162,141	161,906	–	155,739	6,167
Due to fellow Lloyds Banking Group undertakings	119,600	119,600	–	119,600	–
Debt securities in issue	10,184	7,211	–	7,211	–
Subordinated liabilities	6,775	6,785	–	6,785	–
Repos included in above amounts:					
Deposits from banks	19,977	19,977	–	19,977	–

Valuation methodology

Deposits from banks and customer deposits

The fair value of bank and customer deposits repayable on demand is assumed to be equal to their carrying value.

The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities is calculated based on quoted market prices where available. Where quoted market prices are not available, fair value is estimated using discounted cash flow techniques at a rate which reflects market rates of interest and the Group's own credit spread.

40 Financial instruments (continued)

Subordinated liabilities
The fair value of subordinated liabilities is determined by reference to quoted market prices where available or by reference to quoted market prices of similar instruments. Subordinated liabilities are classified as level 2, since the inputs used to determine their fair value are largely observable.

Repurchase agreements
The carrying amount is deemed a reasonable approximation of fair value given the short term nature of these instruments.

(5) Reclassification of financial assets
Other than the reclassifications on adoption of IFRS 9 on 1 January 2018, there have been no reclassifications of financial assets in 2018 or 2019.

41 Transfers of financial assets

There were no significant transferred financial assets which were derecognised in their entirety, but with ongoing exposure. Details of transferred financial assets that continue to be recognised in full are as follows:

The Group and the Bank enters into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets covered as substantially all of the risks and rewards, including credit, interest rate, prepayment and other price risks are retained by the Group. In all cases, the transferee has the right to sell or repledge the assets concerned.

As set out in note 26, included within financial assets measured at amortised cost are loans transferred under the Group's securitisation and covered bond programmes. As the Group retains all of a majority of the risks and rewards associated with these loans, including credit, interest rate, prepayment and liquidity risk, they remain on the Group's balance sheet. Assets transferred into the Group's securitisation and covered bond programmes are not available to be used by the Group whilst the assets are within the programmes. However, the Group retains the right to remove loans from the covered bond programmes where they are in excess of the programme's requirements. In addition, where the Group has retained some of the notes issued by securitisation and covered bond programmes, the Group has the ability to sell or pledge these retained notes.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For repurchase and securities lending transactions, the associated liabilities represent the Group's obligation to repurchase the transferred assets. For securitisation programmes, the associated liabilities represent the external notes in issue (note 26). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

	The Group		**The Bank**	
	Carrying value of transferred assets £m	**Carrying value of associated liabilities £m**	**Carrying value of transferred assets £m**	**Carrying value of associated liabilities £m**
At 31 December 2019				
Repurchase and securities lending transactions				
Financial assets at fair value through profit or loss	**–**	**–**	**–**	**–**
Financial assets at fair value through other comprehensive income	**35**	**–**	**35**	**–**
Securitisation programmes				
Loans and advances to customers[1,2]	**30,417**	**5,616**	**30,417**	**–**

	The Group		**The Bank**	
	Carrying value of transferred assets £m	Carrying value of associated liabilities £m	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
At 31 December 2018				
Repurchase and securities lending transactions				
Financial assets at fair value through profit or loss	9	–	9	–
Financial assets at fair value through other comprehensive income	296	–	296	–
Securitisation programmes				
Loans and advances to customers[1,2]	29,330	4,729	29,330	–

1 The carrying value of associated liabilities for the Group excludes securitisation notes held by the Group of £23,632 million (2018: £22,826 million).

2 The carrying value of transferred assets for the Bank includes amounts relating to assets transferred to structured entities which are fully consolidated into the Group. The liabilities associated with such assets are issued by the structured entities.

42 Offsetting of financial assets and liabilities

The following information relates to financial assets and liabilities which have been offset in the balance sheet and those which have not been offset but for which the Group has enforceable master netting agreements or collateral arrangements in place with counterparties.

The Group At 31 December 2019	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/ pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Financial assets at fair value through profit or loss:						
Excluding reverse repos	463	–	463	–	–	463
Reverse repos	–	–	–	–	–	–
	463	–	463	–	–	463
Derivative financial instruments	10,338	–	10,338	(936)	(883)	8,519
Loans and advances to banks:						
Excluding reverse repos	311	–	311	(239)	–	72
Reverse repos	–	–	–	–	–	–
	311	–	311	(239)	–	72
Loans and advances to customers:						
Excluding reverse repos	258,315	–	258,315	(206)	(668)	257,441
Reverse repos	–	–	–	–	–	–
	258,315	–	258,315	(206)	(668)	257,441
Financial assets at fair value through other comprehensive income	2,253	–	2,253	–	–	2,253
Financial liabilities						
Deposits from banks:						
Excluding repos	1,012	–	1,012	(792)	–	220
Repos	15,460	–	15,460	–	(15,460)	–
	16,472	–	16,472	(792)	(15,460)	220
Customer deposits:						
Excluding repos	151,845	–	151,845	(144)	(668)	151,033
Repos	–	–	–	–	–	–
	151,845	–	151,845	(144)	(668)	151,033
Financial liabilities at fair value through profit or loss:						
Excluding repos	47	–	47	–	–	47
Repos	–	–	–	–	–	–
	47	–	47	–	–	47
Derivative financial instruments	11,352	–	11,352	(445)	(865)	10,042

1 After impairment allowance.

2 The amounts set off in the balance sheet as shown above represent balances with central clearing houses which meet the criteria for offsetting under IAS 32.

3 The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

The effects of over collaterisation have not been taken into account in the above table.

42 Offsetting of financial assets and liabilities (continued)

The Group At 31 December 2018	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3] Cash collateral received/ pledged £m	Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Financial assets at fair value through profit or loss:						
Excluding reverse repos	509	–	509	–	–	509
Reverse repos	–	–	–	–	–	–
	509	–	509	–	–	509
Derivative financial instruments	9,361	–	9,361	(836)	(1,183)	7,342
Loans and advances to banks:						
Excluding reverse repos	471	–	471	(287)	–	184
Reverse repos	–	–	–	–	–	–
	471	–	471	(287)	–	184
Loans and advances to customers:						
Excluding reverse repos	262,324	–	262,324	(144)	(842)	261,338
Reverse repos	–	–	–	–	–	–
	262,324	–	262,324	(144)	(842)	261,338
Financial assets at fair value through other comprehensive income	968	–	968	–	–	968
Financial liabilities						
Deposits from banks:						
Excluding repos	931	–	931	(836)	–	95
Repos	19,977	–	19,977	–	(19,977)	–
	20,908	–	20,908	(836)	(19,977)	95
Customer deposits:						
Excluding repos	162,141	–	162,141	–	(842)	161,299
Repos	–	–	–	–	–	–
	162,141	–	162,141	–	(842)	161,299
Financial liabilities at fair value through profit or loss:						
Excluding repos	103	–	103	–	–	103
Repos	–	–	–	–	–	–
	103	–	103	–	–	103
Derivative financial instruments	10,208	–	10,208	(431)	(1,117)	8,660

1 After impairment allowance.

2 The amounts set off in the balance sheet as shown above represent balances with central clearing houses which meet the criteria for offsetting under IAS 32.

3 The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respective of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.

The effects of over collaterisation have not been taken into account in the above table.

43 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; and liquidity risk. Qualitative and quantitative 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. 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 and measure the credit risk of loans and advances to customers and banks at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the current exposures to the counterparty and their likely future development, from which the Group derives the exposure at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The Group 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 derivatives based transactions.

A. Maximum credit exposure

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

	At 31 December 2019			At 31 December 2018		
The Group	**Maximum exposure £m**	**Offset[2] £m**	**Net exposure £m**	Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and advances to banks, net[1]	**311**	**–**	**311**	471	–	471
Loans and advances to customers, net[1]	**258,315**	**(668)**	**257,647**	262,324	(842)	261,482
Financial assets at amortised cost	**258,626**	**(668)**	**257,958**	262,795	(842)	261,953
Financial assets at fair value through other comprehensive income[3]	**2,253**	**–**	**2,253**	968	–	968
Financial assets at fair value through profit or loss[3]:						
Loans and advances	**463**	**–**	**463**	509	–	509
Debt securities, treasury and other bills	**–**	**–**	**–**	–	–	–
	463	**–**	**463**	509	–	509
Derivative assets	**10,338**	**(865)**	**9,473**	9,361	(1,117)	8,244
Off-balance sheet items:						
Acceptances and endorsements	**1**	**–**	**1**	1	–	1
Other items serving as direct credit substitutes	**20**	**–**	**20**	36	–	36
Performance bonds and other transaction-related contingencies	**199**	**–**	**199**	192	–	192
Irrevocable commitments and guarantees	**14,478**	**–**	**14,478**	13,937	–	13,937
	14,698	**–**	**14,698**	14,166	–	14,166
	286,378	**(1,533)**	**284,845**	287,799	(1,959)	285,840

1 Amounts shown net of related impairment allowances.

2 Offset items comprise deposit amounts available for offset and amounts available for offset under master netting arrangements that 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 Excluding equity shares.

43 Financial risk management (continued)

The Bank	At 31 December 2019 Maximum exposure £m	Offset[2] £m	Net exposure £m	At 31 December 2018 Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and advances to banks, net[1]	**307**	**–**	**307**	471	–	471
Loans and advances to customers, net[1]	**252,931**	**(668)**	**252,263**	256,990	(842)	256,148
Financial assets at amortised cost	**253,238**	**(668)**	**252,570**	257,461	(842)	256,619
Financial assets at fair value through other comprehensive income[3]	**2,253**	**–**	**2,253**	968	–	968
Financial assets at fair value through profit or loss[3]:						
Loans and advances	**117**	**–**	**117**	110	–	110
Debt securities, treasury and other bills	**–**	**–**	**–**	–	–	–
	117	**–**	**117**	110	–	110
Derivative assets	**10,296**	**(865)**	**9,431**	9,225	(1,117)	8,108
Off-balance sheet items:						
Acceptances and endorsements	**1**	**–**	**1**	1	–	1
Other items serving as direct credit substitutes	**20**	**–**	**20**	36	–	36
Performance bonds and other transaction-related contingencies	**199**	**–**	**199**	192	–	192
Irrevocable commitments and guarantees	**14,383**	**–**	**14,383**	13,021	–	13,021
	14,603	**–**	**14,603**	13,250	–	13,250
	280,507	**(1,533)**	**278,974**	281,014	(1,959)	279,055

1 Amounts shown net of related impairment allowances.

2 Offset items comprise deposit amounts available for offset and amounts available for offset under master netting arrangements that 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 Excluding equity shares.

43 Financial risk management (continued)

B. Concentrations of exposure

The Group's management of concentration risk includes single name, industry sector and country limits as well as controls over the Group's overall exposure to certain products.

At 31 December 2019 the Group's most significant concentrations of exposure were in mortgages (comprising 92 per cent of total loans and advances to customers) and to other personal lending (comprising 4 per cent of the total).

Loans and advances to customers

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Agriculture, forestry and fishing	**609**	633	**609**	633
Energy and water supply	**88**	94	**88**	94
Manufacturing	**187**	222	**187**	222
Construction	**874**	1,338	**874**	1,338
Transport, distribution and hotels	**2,527**	2,738	**2,527**	2,738
Postal and telecommunications	**118**	144	**118**	144
Property companies	**3,744**	3,973	**3,769**	4,009
Financial, business and other services	**1,518**	1,663	**1,518**	1,662
Personal:				
Mortgages[1]	**239,923**	242,816	**234,624**	237,520
Other	**10,412**	10,398	**10,404**	10,388
Lease financing	**251**	268	**–**	–
Hire purchase	**149**	152	**149**	152
Total loans and advances to customers before allowance for impairment losses	**260,400**	264,439	**254,867**	258,900
Allowance for impairment losses (note 17)	**(2,085)**	(2,115)	**(1,936)**	(1,910)
Total loans and advances to customers	**258,315**	262,324	**252,931**	256,990

1 Includes both UK and overseas mortgage balances.

Following the continuing reduction in the Group's non-UK activities, an analysis of credit risk exposures by geographical region has not been provided.

43 Financial risk management (continued)

C. Credit quality of assets
Loans and advances
The internal credit ratings systems used by the Group differ between retail and commercial, reflecting the characteristics of these exposures and the way that they are managed internally; these credit ratings are set out below. All probabilities of default (PDs) include forward-looking information and are based on 12 month values, with the exception of credit impaired.

Stage 3 assets include balances of £79 million (with outstanding amounts due of approximately £690 million) which have been subject to a partial write-off and where the Group continues to enforce recovery action.

Stage 2 and Stage 3 assets of the Group with a carrying amount of approximately £53 million were modified during the year. No material gain or loss was recognised by the Group.

The Group – Gross drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	311	–	–	311
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		311	–	–	311
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	220,665	17,928	–	238,593
RMS 7-9	4.51-14.00%	950	3,570	–	4,520
RMS 10	14.01-20.00%	30	763	–	793
RMS 11-13	20.01-99.99%	142	1,907	–	2,049
RMS 14	100%	–	–	5,040	5,040
		221,787	24,168	5,040	250,995
CMS 1-10	0.00-0.50%	5,548	66	–	5,614
CMS 11-14	0.51-3.00%	2,215	269	–	2,484
CMS 15-18	3.01-20.00%	184	473	–	657
CMS 19	20.01-99.99%	7	20	–	27
CMS 20-23	100%	–	–	623	623
		7,954	828	623	9,405
Total loans and advances to customers		229,741	24,996	5,663	260,400

43 Financial risk management (continued)

The Group – Expected credit losses in respect of drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	**93**	**344**	**–**	**437**
RMS 7-9	4.51-14.00%	**37**	**133**	**–**	**170**
RMS 10	14.01-20.00%	**3**	**46**	**–**	**49**
RMS 11-13	20.01-99.99%	**2**	**190**	**–**	**192**
RMS 14	100%	**–**	**–**	**641**	**641**
		135	**713**	**641**	**1,489**
CMS 1-10	0.00-0.50%	**5**	**2**	**–**	**7**
CMS 11-14	0.51-3.00%	**7**	**6**	**–**	**13**
CMS 15-18	3.01-20.00%	**2**	**28**	**–**	**30**
CMS 19	20.01-99.99%	**–**	**–**	**–**	**–**
CMS 20-23	100%	**–**	**–**	**546**	**546**
		14	**36**	**546**	**596**
Total loans and advances to customers		**149**	**749**	**1,187**	**2,085**

43 Financial risk management (continued)

The Group – Gross undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	**33,047**	**1,470**	–	**34,517**
RMS 7-9	4.51-14.00%	**79**	**35**	–	**114**
RMS 10	14.01-20.00%	**1**	**8**	–	**9**
RMS 11-13	20.01-99.99%	–	**11**	–	**11**
RMS 14	100%	–	–	**39**	**39**
		33,127	**1,524**	**39**	**34,690**
CMS 1-10	0.00-0.50%	**2,082**	**8**	–	**2,090**
CMS 11-14	0.51-3.00%	**821**	**107**	–	**928**
CMS 15-18	3.01-20.00%	**28**	**173**	–	**201**
CMS 19	20.01-99.99%	–	**2**	–	**2**
CMS 20-23	100%	–	–	**1**	**1**
		2,931	**290**	**1**	**3,222**
Total loans and advances to customers		**36,058**	**1,814**	**40**	**37,912**

43 Financial risk management (continued)

The Group – Expected credit losses in respect of undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	**21**	**14**	–	**35**
RMS 7-9	4.51-14.00%	**2**	**3**	–	**5**
RMS 10	14.01-20.00%	–	**1**	–	**1**
RMS 11-13	20.01-99.99%	–	**4**	–	**4**
RMS 14	100%	–	–	–	–
		23	**22**	–	**45**
CMS 1-10	0.00-0.50%	**2**	–	–	**2**
CMS 11-14	0.51-3.00%	**1**	**1**	–	**2**
CMS 15-18	3.01-20.00%	–	**5**	–	**5**
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	**1**	**1**
		3	**6**	**1**	**10**
Total loans and advances to customer		**26**	**28**	**1**	**55**

43 Financial risk management (continued)

The Group – Gross drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	471	–	–	471
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		471	–	–	471
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	224,136	18,096	–	242,232
RMS 7-9	4.51-14.00%	627	3,251	–	3,878
RMS 10	14.01-20.00%	17	632	–	649
RMS 11-13	20.01-99.99%	295	2,028	–	2,323
RMS 14	100%	–	–	4,573	4,573
		225,075	24,007	4,573	253,655
CMS 1-10	0.00-0.50%	5,064	77	–	5,141
CMS 11-14	0.51-3.00%	2,639	627	–	3,266
CMS 15-18	3.01-20.00%	173	626	–	799
CMS 19	20.01-99.99%	–	8	–	8
CMS 20-23	100%	–	–	1,570	1,570
		7,876	1,338	1,570	10,784
Total loans and advances to customer		232,951	25,345	6,143	264,439

43 Financial risk management (continued)

The Group – Expected credit losses inrespect of drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	110	395	–	505
RMS 7-9	4.51-14.00%	24	146	–	170
RMS 10	14.01-20.00%	2	42	–	44
RMS 11-13	20.01-99.99%	1	215	–	216
RMS 14	100%	–	–	786	786
		137	798	786	1,721
CMS 1-10	0.00-0.50%	5	1	–	6
CMS 11-14	0.51-3.00%	6	13	–	19
CMS 15-18	3.01-20.00%	1	45	–	46
CMS 19	20.01-99.99%	–	1	–	1
CMS 20-23	100%	–	–	322	322
		12	60	322	394
Total loans and advances to customer		149	858	1,108	2,115

43 Financial risk management (continued)

The Group – Gross undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	31,090	1,316	–	32,406
RMS 7-9	4.51-14.00%	88	57	–	145
RMS 10	14.01-20.00%	2	12	–	14
RMS 11-13	20.01-99.99%	360	22	–	382
RMS 14	100%	–	–	37	37
		31,540	1,407	37	32,984
CMS 1-10	0.00-0.50%	2,289	–	–	2,289
CMS 11-14	0.51-3.00%	956	9	–	965
CMS 15-18	3.01-20.00%	28	68	–	96
CMS 19	20.01-99.99%	–	8	–	8
CMS 20-23	100%	–	–	–	–
		3,273	85	–	3,358
Total loans and advances to customer		34,813	1,492	37	36,342

43 Financial risk management (continued)

The Group – Expected credit losses in respect of undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	20	12	–	32
RMS 7-9	4.51-14.00%	2	3	–	5
RMS 10	14.01-20.00%	–	1	–	1
RMS 11-13	20.01-99.99%	–	4	–	4
RMS 14	100%	–	–	–	–
		22	20	–	42
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	2	–	–	2
CMS 15-18	3.01-20.00%	–	3	–	3
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	3	3
		2	3	3	8
Total loans and advances to customer		24	23	3	50

43 Financial risk management (continued)

The Bank – Gross drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	307	–	–	307
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		307	–	–	307
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	217,018	17,135	–	234,153
RMS 7-9	4.51-14.00%	944	3,374	–	4,318
RMS 10	14.01-20.00%	30	711	–	741
RMS 11-13	20.01-99.99%	9	1,810	–	1,819
RMS 14	100%	–	–	4,659	4,659
		218,001	23,030	4,659	245,690
CMS 1-10	0.00-0.50%	5,296	65	–	5,361
CMS 11-14	0.51-3.00%	2,215	269	–	2,484
CMS 15-18	3.01-20.00%	184	473	–	657
CMS 19	20.01-99.99%	7	20	–	27
CMS 20-23	100%	–	–	648	648
		7,702	827	648	9,177
Total loans and advances to customer		225,703	23,857	5,307	254,867

43 Financial risk management (continued)

The Bank – Expected credit losses in respect of drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	**91**	**308**	–	**399**
RMS 7-9	4.51-14.00%	**37**	**119**	–	**156**
RMS 10	14.01-20.00%	**3**	**42**	–	**45**
RMS 11-13	20.01-99.99%	**2**	**177**	–	**179**
RMS 14	100%	–	–	**551**	**551**
		133	**646**	**551**	**1,330**
CMS 1-10	0.00-0.50%	**5**	**2**	–	**7**
CMS 11-14	0.51-3.00%	**7**	**6**	–	**13**
CMS 15-18	3.01-20.00%	**2**	**28**	–	**30**
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	**556**	**556**
		14	**36**	**556**	**606**
Total loans and advances to customer		**147**	**682**	**1,107**	**1,936**

43 Financial risk management (continued)

The Bank – Gross undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	**32,931**	**1,417**	–	**34,348**
RMS 7-9	4.51-14.00%	**79**	**35**	–	**114**
RMS 10	14.01-20.00%	**1**	**8**	–	**9**
RMS 11-13	20.01-99.99%	–	**11**	–	**11**
RMS 14	100%	–	–	**39**	**39**
		33,011	**1,471**	**39**	**34,521**
CMS 1-10	0.00-0.50%	**2,082**	**8**	–	**2,090**
CMS 11-14	0.51-3.00%	**821**	**107**	–	**928**
CMS 15-18	3.01-20.00%	**28**	**173**	–	**201**
CMS 19	20.01-99.99%	–	**2**	–	**2**
CMS 20-23	100%	–	–	**1**	**1**
		2,931	**290**	**1**	**3,222**
Total loans and advances to customer		**35,942**	**1,761**	**40**	**37,743**

43 Financial risk management (continued)

The Bank – Expected credit losses in respect of undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2019					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	**21**	**14**	–	**35**
RMS 7-9	4.51-14.00%	**2**	**3**	–	**5**
RMS 10	14.01-20.00%	–	**1**	–	**1**
RMS 11-13	20.01-99.99%	–	**4**	–	**4**
RMS 14	100%	–	–	–	–
		23	**22**	–	**45**
CMS 1-10	0.00-0.50%	**2**	–	–	**2**
CMS 11-14	0.51-3.00%	**1**	**1**	–	**2**
CMS 15-18	3.01-20.00%	–	**5**	–	**5**
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	**1**	**1**
		3	**6**	**1**	**10**
Total loans and advances to customer		**26**	**28**	**1**	**55**

43 Financial risk management (continued)

The Bank – Gross drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	471	–	–	471
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		471	–	–	471
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	220,454	17,191	–	237,645
RMS 7-9	4.51-14.00%	605	3,060	–	3,665
RMS 10	14.01-20.00%	17	591	–	608
RMS 11-13	20.01-99.99%	5	1,899	–	1,904
RMS 14	100%	–	–	4,106	4,106
		221,081	22,741	4,106	247,928
CMS 1-10	0.00-0.50%	5,279	84	–	5,363
CMS 11-14	0.51-3.00%	2,605	627	–	3,232
CMS 15-18	3.01-20.00%	173	626	–	799
CMS 19	20.01-99.99%	–	8	–	8
CMS 20-23	100%	–	–	1,570	1,570
		8,057	1,345	1,570	10,972
Total loans and advances to customer		229,138	24,086	5,676	258,900

43 Financial risk management (continued)

The Bank – Expected credit losses inrespect of drawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	109	356	–	465
RMS 7-9	4.51-14.00%	23	127	–	150
RMS 10	14.01-20.00%	2	37	–	39
RMS 11-13	20.01-99.99%	1	194	–	195
RMS 14	100%	–	–	667	667
		135	714	667	1,516
CMS 1-10	0.00-0.50%	5	1	–	6
CMS 11-14	0.51-3.00%	6	13	–	19
CMS 15-18	3.01-20.00%	1	45	–	46
CMS 19	20.01-99.99%	–	1	–	1
CMS 20-23	100%	–	–	322	322
		12	60	322	394
Total loans and advances to customer		147	774	989	1,910

43 Financial risk management (continued)

The Bank – Gross undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to banks:					
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	–	–	–	–
CMS 15-18	3.01-20.00%	–	–	–	–
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	–	–
		–	–	–	–
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	30,903	1,261	–	32,164
RMS 7-9	4.51-14.00%	88	56	–	144
RMS 10	14.01-20.00%	2	12	–	14
RMS 11-13	20.01-99.99%	–	22	–	22
RMS 14	100%	–	–	35	35
		30,993	1,351	35	32,379
CMS 1-10	0.00-0.50%	2,289	–	–	2,289
CMS 11-14	0.51-3.00%	956	9	–	965
CMS 15-18	3.01-20.00%	28	68	–	96
CMS 19	20.01-99.99%	–	8	–	8
CMS 20-23	100%	–	–	–	–
		3,273	85	–	3,358
Total loans and advances to customer		34,266	1,436	35	35,737

43 Financial risk management (continued)

The Bank – Expected credit losses in respect of undrawn exposures	PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2018					
Loans and advances to customers:					
RMS 1-6	0.00-4.50%	20	12	–	32
RMS 7-9	4.51-14.00%	2	3	–	5
RMS 10	14.01-20.00%	–	1	–	1
RMS 11-13	20.01-99.99%	–	4	–	4
RMS 14	100%	–	–	–	–
		22	20	–	42
CMS 1-10	0.00-0.50%	–	–	–	–
CMS 11-14	0.51-3.00%	2	–	–	2
CMS 15-18	3.01-20.00%	–	3	–	3
CMS 19	20.01-99.99%	–	–	–	–
CMS 20-23	100%	–	–	3	3
		2	3	3	8
Total loans and advances to customer		24	23	3	50

43 Financial risk management (continued)

Debt securities held at amortised cost
An analysis by credit rating of debt securities amortised at cost is provided below:

The Group	2019 Investment grade[1] £m	2019 Other[2] £m	2019 Total £m	2018 Investment grade[1] £m	2018 Other[2] £m	2018 Total £m
Corporate and other debt securities	–	1	1	–	13	13
Gross exposure	–	1	1	–	13	13
Allowance for impairment losses			(1)			(13)
Total debt securities held at amortised cost			–			–

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019: £nil; 2018: £nil) and not rated (2019: £1 million; 2018: £13 million).

The Bank	2019 Investment grade[1] £m	2019 Other[2] £m	2019 Total £m	2018 Investment grade[1] £m	2018 Other[2] £m	2018 Total £m
Corporate and other debt securities	–	1	1	–	13	13
Gross exposure	–	1	1	–	13	13
Allowance for impairment losses			(1)			(13)
Total debt securities held at amortised cost			–			–

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019: £nil; 2018: £nil) and not rated (2019: £1 million; 2018: £13 million).

Financial assets at fair value through other comprehensive income (excluding equity shares)
An analysis of financial assets at fair value through other comprehensive income is included in note 18. The credit quality of financial assets at fair value through other comprehensive income (excluding equity shares) is set out below:

The Group	2019 Investment grade[1] £m	2019 Other[2] £m	2019 Total £m	2018 Investment grade[1] £m	2018 Other[2] £m	2018 Total £m
Corporate and other debt securities	2,253	–	2,253	783	185	968
Total financial assets at fair value through other comprehensive income	2,253	–	2,253	783	185	968

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019: £nil; 2018: £nil) and not rated (2019: £nil; 2018: £185 million).

The Bank	2019 Investment grade[1] £m	2019 Other[2] £m	2019 Total £m	2018 Investment grade[1] £m	2018 Other[2] £m	2018 Total £m
Corporate and other debt securities	2,253	–	2,253	783	185	968
Total financial assets at fair value through other comprehensive income	2,253	–	2,253	783	185	968

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019: £nil; 2018: £nil) and not rated (2019: £nil; 2018: £185 million).

43 Financial risk management (continued)

Derivative assets
An analysis of derivative assets is given in note 14. 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 credit risk relating to derivative assets of £9,473 million for the Group and £9,431 million for the Bank (2018: £8,244 million for the Group and £8,108 million for the Bank), cash collateral of £936 million for the Group and the Bank (2018: £836 million for the Group and £836 million for the Bank) was held and a further £54 million for the Group and the Bank was due from OECD banks (2018: £62 million for the Group and the Bank).

	2019			2018		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Derivative financial instruments						
The Group						
Trading and other	**1,838**	**1,056**	**2,894**	1,712	796	2,508
Hedging	**418**	**–**	**418**	652	–	652
	2,256	**1,056**	**3,312**	2,364	796	3,160
Due from fellow Group undertakings			**7,026**			6,201
Total derivative financial instruments			**10,338**			9,361
The Bank						
Trading and other	**1,796**	**1,056**	**2,852**	1,576	796	2,372
Hedging	**418**	**–**	**418**	652	–	652
	2,214	**1,056**	**3,270**	2,228	796	3,024
Due from fellow Group undertakings			**7,026**			6,201
Total derivative financial instruments			**10,296**			9,225

1 Credit ratings equal to or better than 'BBB'.

2 Other comprises sub-investment grade (2019 the Group and the Bank: £760 million; 2018 the Group and the Bank: £794 million) and not rated (2019 the Group and Bank: £296 million; 2018 the Group and the Bank: £2 million).

Financial guarantees and irrevocable loan commitments
Financial guarantees 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.

D. Collateral held as security for financial assets
The Group holds collateral against loans and advances and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for financial assets at fair value through profit or loss and for derivative assets is also shown below.

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 financial assets held at amortised cost.

Loans and advances to banks
These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Loans and advances to customers
Retail lending
Mortgages
An analysis by loan-to-value ratio of the Group's and the Bank's UK 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 allowances for indexation error and dilapidations.

In some circumstances, where the discounted value of the estimated net proceeds from the liquidation of collateral (i.e. net of costs, expected haircuts and anticipated changes in the value of the collateral to the point of sale) is greater than the estimated exposure at default, no credit losses are expected and no ECL allowance is recognised.

43 Financial risk management (continued)

The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total gross £m
At 31 December 2019				
Less than 70 per cent	**142,536**	**17,780**	**2,414**	**162,730**
70 per cent to 80 per cent	**39,580**	**3,118**	**516**	**43,214**
80 per cent to 90 per cent	**24,395**	**1,330**	**308**	**26,033**
90 per cent to 100 per cent	**5,043**	**286**	**143**	**5,472**
Greater than 100 per cent	**306**	**434**	**304**	**1,044**
Total	**211,860**	**22,948**	**3,685**	**238,493**

The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total gross £m
At 31 December 2018				
Less than 70 per cent	145,283	17,434	2,680	165,397
70 per cent to 80 per cent	34,197	2,774	570	37,541
80 per cent to 90 per cent	24,019	1,458	408	25,885
90 per cent to 100 per cent	4,609	372	188	5,169
Greater than 100 per cent	393	481	374	1,248
Total	208,501	22,519	4,220	235,240

The Bank	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total gross £m
At 31 December 2019				
Less than 70 per cent	**140,386**	**17,034**	**2,233**	**159,653**
70 per cent to 80 per cent	**39,080**	**2,919**	**451**	**42,450**
80 per cent to 90 per cent	**24,277**	**1,252**	**266**	**25,795**
90 per cent to 100 per cent	**5,011**	**263**	**116**	**5,390**
Greater than 100 per cent	**244**	**367**	**238**	**849**
Total	**208,998**	**21,835**	**3,304**	**234,137**

The Bank	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total gross £m
At 31 December 2018				
Less than 70 per cent	142,882	16,587	2,456	161,925
70 per cent to 80 per cent	33,650	2,580	491	36,721
80 per cent to 90 per cent	23,814	1,364	345	25,523
90 per cent to 100 per cent	4,548	336	158	5,042
Greater than 100 per cent	327	410	294	1,031
Total	205,221	21,277	3,744	230,242

Commercial lending

Stage 3 secured 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.

At 31 December 2019, Stage 3 secured commercial lending amounted to £546 million, net of an impairment allowance of £48 million (2018: £469 million, net of an impairment allowance of £58 million). The fair value of the collateral held in respect of Stage 3 secured commercial lending was £275 million (2018: £182 million). 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 Stage 3 secured commercial 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.

Stage 3 secured commercial 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.

Stage 1 and Stage 2 secured lending

For Stage 1 and Stage 2 secured commercial lending, 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.

43 Financial risk management (continued)

Stage 1 and Stage 2 secured commercial lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for Stage 3 lending, this will not always involve assessing it on a fair value basis. No aggregated collateral information for the entire unimpaired secured commercial lending portfolio is provided to key management personnel.

Financial assets at fair value through profit or loss (excluding equity shares)
There were no repurchase agreements included in financial assets at fair value through profit or loss for either the Group or the Bank at 31 December in either 2019 or 2018.

In addition, securities held as collateral in the form of stock borrowed amounted to £20,366 million for the Group and the Bank (2018: £35,743 million for the Group and the Bank). At 31 December 2019, £20,366 million for the Group and the Bank had been resold or repledged as collateral for the Group's own transactions (2018: £35,639 million for the Group and the Bank).

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 £9,473 million for the Group and £9,431 million for the Bank (2018: £8,244 million for the Group and £8,108 million for the Bank), cash collateral of £936 million for the Group and the Bank (2018: £836 million for the Group and the Bank) was held.

Irrevocable loan commitments and other credit-related contingencies
At 31 December 2019, there were irrevocable loan commitments and other credit-related contingencies of £14,698 million for the Group and £14,603 million for the Bank (2018: £14,166 million for the Group and £13,250 million for the Bank). Collateral is held as security, in the event that lending is drawn down, on £11,271 million for the Group and on £11,143 million for the Bank (2018: £9,962 million for the Group and £9,827 million for the Bank) of these balances.

Collateral repossessed
During the year, £387 million for the Group and £351 million for the Bank of collateral was repossessed (2018: £218 million for the Group and £189 million for the Bank), consisting primarily of residential property. 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 commercial lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

E. Collateral pledged as security

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.

Repurchase transactions
Deposits from banks
Included in deposits from banks are deposits held as collateral for facilities granted, with a carrying value of £15,460 million for the Group and the Bank (2018: £19,977 million for the Group and Bank); the fair value of the collateral provided under these agreements at 31 December 2019 was £15,427 million for the Group and the Bank (2018: £18,427 million for the Group and Bank).

Trading and other financial liabilities at fair value through profit or loss
There were no repurchase transactions included in financial liabilities at fair value through profit or loss for either the Group or the Bank at 31 December in either 2019 or 2018.

Securities lending transactions
The following on balance sheet financial assets have been lent to counterparties under securities lending transactions:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Financial assets at fair value through profit and loss	**–**	9	**–**	9
Financial assets at fair value through other comprehensive income	**35**	296	**35**	296
	35	305	**35**	305

Securitisations and covered bonds
In addition to the assets detailed above, the Group also holds assets that are encumbered through the Group's securitisation and covered bond programmes. Further details of these are provided in note 26.

(2) Market risk
Interest rate risk
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. The rates on the remaining deposits are 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 many personal loans and mortgages, bear interest rates which are contractually fixed.

43 Financial risk management (continued)

The Group's risk management policy is to optimise reward whilst managing its market risk exposures within the risk appetite defined by the Board. The largest residual risk exposure arises from balances that are deemed to be insensitive to changes in market rates (including current accounts, a portion of variable rate deposits and investable equity), and is managed through the Group's structural hedge. The structural hedge consists of longer-term fixed rate assets or interest rate swaps and the amount and duration of the hedging activity is reviewed regularly by the Lloyds Banking Group Asset and Liability Committee.

The Group and the Bank establishes hedge accounting relationships for interest rate risk using cash flow hedges and fair value hedges. The Group and the Bank are exposed to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The derivatives used to manage the structural hedge may be designated into cash flow hedges to manage income statement volatility. The economic items related to the structural hedge, for example current accounts, are not eligible hedged items under IAS 39 for inclusion into accounting hedge relationships. The Group and the Bank are 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 Group and the Bank apply netting between similar risks before applying hedge accounting.

Hedge ineffectiveness arises during the management of interest rate risk due to residual unhedged risk. Sources of ineffectiveness, which the Group may decide to not fully mitigate, can include basis differences, timing differences and notional amount differences. The effectiveness of accounting hedge relationships is assessed between the hedging derivatives and the documented hedged item, which can differ to the underlying economically hedged item.

At 31 December 2019 the aggregate notional principal of interest rate swaps designated as fair value hedges was £6,051 million (2018: £11,186 million) for the Group and the Bank with a net fair value asset of £710 million (2018: £1,325 million) for the Group and the Bank (see note 14). The losses on the hedging instruments were £94 million (2018: losses of £371 million) for the Group and the Bank. The gains on the hedged items attributable to the hedged risk were £97 million (2018: gains of £367 million) for the Group and the Bank. The gains and losses relating to the fair value hedges are recorded in net trading income.

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 commercial business. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2019 was £13,227 million (2018: £19,464 million) for the Group and the Bank with a net fair value liability of £183 million (2018: liability of £490 million) for the Group and the Bank (see note 14). In 2019, ineffectiveness recognised in the income statement that arises from cash flow liability was £nil (2018: gain of £2 million) for the Group and the Bank.

Interest Rate Benchmark Reform
As discussed in note 1, the Group has applied the hedge accounting amendments Interest Rate Benchmark Reform to hedge accounting relationships directly affected by the replacement of interest rate benchmarks. Under these amendments, for the purposes of:

- determining whether a forecast transaction is highly probable;
- determining whether the hedged future cash flows are expected to occur;
- determining whether a hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk; and
- determining whether an accounting hedging relationship should be discontinued because of a failure of the retrospective effectiveness test

the Group has assumed that the interest rate benchmark on which the hedged risk or the cash flows of the hedged item or hedging instrument are based is not altered by uncertainties resulting from the proposed interest rate benchmark reform. In addition, for a fair value hedge of a non-contractually specified benchmark portion of interest rate risk, the Group assesses only at inception of the hedge relationship and not on an ongoing basis that the risk is separately identifiable and hedge effectiveness can be measured.

The Group's most significant hedge accounting relationships are exposed to the following interest rate benchmarks: Sterling LIBOR, US Dollar LIBOR and Euro LIBOR. The notional of the hedged items that the Group and the Bank has designated into cash-flow hedge relationships that is directly affected by the interest rate benchmark reform is £4,038 million, of which £3,858 million relates to Sterling LIBOR. These are principally loans and advances to customers in Commercial Banking. In addition, the interest rate benchmark reforms affect, for the Group and the Bank, assets designated in fair value hedges with a notional of £602 million, of which £602 million is in respect of sterling LIBOR, and liabilities designated in fair value hedges with a notional of £5,685 million, of which £818 million is in respect of sterling LIBOR. These fair value hedges principally relate to debt securities in issue.

The Group is managing the process to transition to alternative benchmark rates under its Group-wide IBOR Transition Programme. This programme is working towards ensuring that the Group has the market capability and infrastructure to deal with the reform. The programme also encompasses the associated impacts on accounting and reporting and includes dealing with the impact on hedge accounting relationships of the transition to alternative reference rates.

The significant assumptions and judgements that the Group has made in applying these requirements include the following:

- a hedge accounting relationship is assumed to be affected by the interest rate benchmark reform if the reform gives rise to uncertainties about the timing and/or amount of the interest rate benchmark-based cash flows of the hedged items and/or of the hedging instrument;
- where the hedged item is a forecast transaction then, in the absence of any certainty in relation to the interest rate benchmark reform, assessments have been determined as to whether the forecast transaction is highly probable assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the interest rate benchmark reform;
- any reclassification of amounts in cash flow hedge reserves to profit or loss have been based on assessing whether the hedged cash flows are no longer expected to occur assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the interest rate benchmark reform; and
- all benchmark rate referenced hedged items and hedging instruments included in hedging relationships are subject to uncertainty due to interest rate benchmark reform.

In accordance with the Interest Rate Benchmark Reform amendments to IAS 39, the Group will cease to apply prospectively the reliefs outlined above when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item (or for the effectiveness assessments, the hedging instrument). The reliefs will be disapplied earlier if the hedging relationship is discontinued or the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss for a reason other than interest rate benchmark reform.

At 31 December 2019, the notional amount of the Group's and the Bank's hedging instruments in hedging relationships to which these amendments apply was £19,279 million, of which £1,497 million relates to Sterling LIBOR fair value hedges and £12,823 million relates to Sterling LIBOR cash flow hedges.

43 Financial risk management (continued)

Currency risk

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 and liquidity risk function in London.

The Group also manages foreign currency risk via cash flow hedge accounting, utilising currency swaps.

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 ceased all hedging of the currency translation risk of the net investment in foreign operations on 1 January 2018.

The Group's main overseas operations are in Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

Functional currency of Group operations

The Group	**Euro £m**
31 December 2019	
Gross exposure	**162**
Net investment hedges	**–**
Total structural foreign currency exposures, after net investment hedges	**162**
31 December 2018	
Gross exposure	131
Net investment hedges	–
Total structural foreign currency exposures, after net investment hedges	131

The Bank	**Euro £m**
31 December 2019	
Gross exposure	**193**
Net investment hedges	**–**
Total structural foreign currency exposures, after net investment hedges	**193**
31 December 2018	
Gross exposure	114
Net investment hedges	–
Total structural foreign currency exposures, after net investment hedges	114

43 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. Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The table below analyses financial instrument liabilities of the Group, 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. Certain balances, included in the table below on the basis of their residual maturity, are repayable on demand upon payment of a penalty.

The Group	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2019						
Liabilities						
Deposits from banks	**166**	**–**	**105**	**16,318**	**–**	**16,589**
Customer deposits	**135,377**	**1,820**	**7,134**	**7,924**	**13**	**152,268**
Financial liabilities at fair value through profit or loss	**–**	**–**	**–**	**–**	**47**	**47**
Debt securities in issue	**599**	**2,098**	**2,120**	**6,120**	**827**	**11,764**
Other liabilities (lease liabilities)	**1**	**25**	**77**	**344**	**421**	**868**
Subordinated liabilities	**67**	**69**	**107**	**1,504**	**9,853**	**11,600**
Total non-derivative financial liabilities	**136,210**	**4,012**	**9,543**	**32,210**	**11,161**	**193,136**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**862**	**147**	**588**	**1,772**	**1,754**	**5,123**
Gross settled derivatives – inflows	**(36)**	**(113)**	**(585)**	**(1,800)**	**(1,918)**	**(4,452)**
Gross settled derivatives – net flows	**826**	**34**	**3**	**(28)**	**(164)**	**671**
Net settled derivative liabilities	**4,030**	**5**	**15**	**47**	**140**	**4,237**
Total derivative financial liabilities	**4,856**	**39**	**18**	**19**	**(24)**	**4,908**
At 31 December 2018						
Liabilities						
Deposits from banks	43	925	162	20,190	–	21,320
Customer deposits	142,017	2,453	8,111	9,131	727	162,439
Financial liabilities at fair value through profit or loss	–	–	–	50	54	104
Debt securities in issue	463	678	1,556	8,877	1,034	12,608
Subordinated liabilities	809	30	1,165	4,618	522	7,144
Total non-derivative financial liabilities	143,332	4,086	10,994	42,866	2,337	203,615
Derivative financial liabilities:						
Gross settled derivatives – outflows	78	74	139	3,367	1,298	4,956
Gross settled derivatives – inflows	(40)	(62)	(131)	(3,181)	(1,155)	(4,569)
Gross settled derivatives – net flows	38	12	8	186	143	387
Net settled derivative liabilities	1,476	9	32	134	225	1,876
Total derivative financial liabilities	1,514	21	40	320	368	2,263

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £8 million (2018: £7 million) for the Group and the Bank per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond five years.

43 Financial risk management (continued)

The Bank	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2019						
Liabilities						
Deposits from banks	**166**	**–**	**105**	**16,318**	**–**	**16,589**
Customer deposits	**135,377**	**1,820**	**7,134**	**7,898**	**13**	**152,242**
Debt securities in issue	**267**	**1,371**	**395**	**3,401**	**662**	**6,096**
Other liabilities (lease liabilities)	**1**	**25**	**77**	**344**	**421**	**868**
Subordinated liabilities	**67**	**63**	**101**	**1,342**	**9,853**	**11,426**
Total non-derivative financial liabilities	**135,878**	**3,279**	**7,812**	**29,303**	**10,949**	**187,221**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**862**	**147**	**588**	**1,772**	**1,754**	**5,123**
Gross settled derivatives – inflows	**(36)**	**(113)**	**(585)**	**(1,800)**	**(1,918)**	**(4,452)**
Gross settled derivatives – net flows	**826**	**34**	**3**	**(28)**	**(164)**	**671**
Net settled derivative liabilities	**4,030**	**5**	**15**	**55**	**90**	**4,195**
Total derivative financial liabilities	**4,856**	**39**	**18**	**27**	**(74)**	**4,866**
At 31 December 2018						
Liabilities						
Deposits from banks	43	925	162	20,188	–	21,318
Customer deposits	142,017	2,453	8,111	9,131	727	162,439
Financial liabilities at fair value through profit or loss	–	–	–	50	–	50
Debt securities in issue	1,767	696	5,482	18,915	4,067	30,927
Subordinated liabilities	851	32	1,126	4,665	443	7,117
Total non-derivative financial liabilities	144,678	4,106	14,881	52,949	5,237	221,851
Derivative financial liabilities:						
Gross settled derivatives – outflow	78	74	139	3,367	1,298	4,956
Gross settled derivatives – inflow	(40)	(62)	(131)	(3,181)	(1,155)	(4,569)
Gross settled derivatives – netflow	38	12	8	186	143	387
Net settled derivative liabilities	1,476	9	32	134	171	1,822
Total derivative financial liabilities	1,514	21	40	320	314	2,209

43 Financial risk management (continued)

The following tables set out the amounts and residual maturities of the Group's off balance sheet contingent liabilities, commitments and guarantees.

The Group	**Within 1 year £m**	**1-3 years £m**	**3-5 years £m**	**Over 5 years £m**	**Total £m**
31 December 2019					
Acceptances and endorsements	**1**	**–**	**–**	**–**	**1**
Other contingent liabilities	**97**	**17**	**1**	**104**	**219**
Total contingent liabilities	**98**	**17**	**1**	**104**	**220**
Lending commitments and guarantees	**35,488**	**945**	**646**	**819**	**37,898**
Other commitments	**–**	**–**	**–**	**14**	**14**
Total commitments and guarantees	**35,488**	**945**	**646**	**833**	**37,912**
Total contingents, commitments and guarantees	**35,586**	**962**	**647**	**937**	**38,132**

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2018					
Acceptances and endorsements	1	–	–	–	1
Other contingent liabilities	84	20	–	124	228
Total contingent liabilities	85	20	–	124	229
Lending commitments and guarantees	33,083	1,118	725	1,368	36,294
Other commitments	1	–	–	47	48
Total commitments and guarantees	33,084	1,118	725	1,415	36,342
Total contingents, commitments and guarantees	33,169	1,138	725	1,539	36,571

The Bank	**Within 1 year £m**	**1-3 years £m**	**3-5 years £m**	**Over 5 years £m**	**Total £m**
31 December 2019					
Acceptances and endorsements	**1**	**–**	**–**	**–**	**1**
Other contingent liabilities	**97**	**17**	**1**	**104**	**219**
Total contingent liabilities	**98**	**17**	**1**	**104**	**220**
Lending commitments and guarantees	**35,319**	**945**	**646**	**819**	**37,729**
Other commitments	**–**	**–**	**–**	**14**	**14**
Total commitments and guarantees	**35,319**	**945**	**646**	**833**	**37,743**
Total contingents, commitments and guarantees	**35,417**	**962**	**647**	**937**	**37,963**

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2018					
Acceptances and endorsements	1	–	–	–	1
Other contingent liabilities	84	20	–	124	228
Total contingent liabilities	85	20	–	124	229
Lending commitments and guarantees	32,478	1,118	725	1,368	35,689
Other commitments	1	–	–	47	48
Total commitments and guarantees	32,479	1,118	725	1,415	35,737
Total contingents, commitments and guarantees	32,564	1,138	725	1,539	35,966

44 Capital

Capital management
Capital is actively managed on an ongoing basis, covering the Group, the Bank on an individual basis and its regulated subsidiaries. Regulatory capital ratios are a key factor in budgeting and planning processes with updates on forecast ratios reviewed by the Lloyds Banking Group and Ring-Fenced Bank's Asset and Liability Committee. Target capital levels take account of regulatory requirements, capacity for growth and to cover uncertainties. Capital policies and procedures are subject to independent oversight.

The Group measures both its capital requirements and the amount of capital resources it holds to meet those requirements through applying the regulatory framework defined by the Capital Requirements Directive and Regulation (CRD IV), as amended by provisions of the revised Capital Requirements Regulation (CRR II) that came into force in June 2019. Directive requirements are implemented in the UK by the Prudential Regulation Authority (PRA) and supplemented through additional regulation under the PRA Rulebook.

The minimum amount of total capital, under Pillar 1 of the regulatory framework, is set at 8 per cent of total risk-weighted assets. At least 4.5 per cent of risk-weighted assets are required to be covered by common equity tier 1 (CET1) capital and at least 6 per cent of risk-weighted assets are required to be covered by tier 1 capital. These minimum Pillar 1 requirements are supplemented by additional minimum requirements under Pillar 2A of the regulatory framework, the aggregate of which is referred to as the Total Capital Requirement (TCR).

Under Pillar 2A, additional requirements are set through the issuance of a bank specific Individual Capital Requirement (ICR), which adjusts the Pillar 1 minimum requirement for those risks not covered or not fully covered under Pillar 1. A key input into the PRA's ICR process is a bank's own assessment of the amount of capital it needs, a process known as the Internal Capital Adequacy Assessment Process (ICAAP).

A range of additional bank specific regulatory capital buffers apply under CRD IV, which are required to be met with CET1 capital. These include a capital conservation buffer (2.5 per cent of risk-weighted assets) and a time-varying countercyclical capital buffer (1.0 per cent of risk-weighted assets at 31 December 2019).

The Group has adopted the IFRS 9 transitional arrangements for capital set out under the relevant CRD IV amendment. The arrangements allow for the initial net impact of IFRS 9 on CET1 capital, resulting from the increase in accounting impairment provisions, plus the capital impact of any subsequent increases in Stage 1 and Stage 2 expected credit losses (net of movements in regulatory expected losses), to be phased in over a five year transition period. For 2019 the phase in factor allowed 85 per cent of the resultant transitional adjustment to be added back to CET1 capital. The phase in factor will reduce to 70 per cent in 2020. As at 31 December 2019 no additional capital relief in respect of post 1 January 2018 increases in Stage 1 and Stage 2 expected credit losses (net of movements in regulatory expected losses) has been recognised.

During the year, the individual regulated entities within the Group and the Group itself complied with all of the externally imposed capital requirements to which they are subject.

Regulatory capital development
The regulatory framework within which the Group operates continues to be developed at a global level through the Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS), at a European level mainly through the European Commission (EC) and the issuance of technical standards and guidelines by the European Banking Authority (EBA) and within the UK by the PRA and through directions from the Financial Policy Committee (FPC). The Group continues to monitor these developments very closely, analysing potential capital impacts to ensure the Group and individual regulated entities continue to maintain a strong capital position that exceeds the minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Capital resources
Regulatory capital is divided into tiers depending on the degree of permanency and loss absorbency exhibited.

- Common equity tier 1 (CET1) capital represents the strongest form of capital consisting of shareholders' equity after a number of regulatory adjustments and deductions are applied. These include adjustments for IFRS 9 transitional arrangements, the accrual for foreseeable dividends (where applicable), the elimination of the cash flow hedging reserve and deductions for goodwill, other intangible assets, prudent valuation, defined benefit pension surplus and deferred tax assets.
- Fully qualifying additional tier 1 (AT1) capital comprises non-cumulative perpetual securities containing specific provisions to write down the security should the CET1 ratio fall to a defined trigger limit. Under transitional rules for capital, securities that do not qualify in their own right as AT1 capital, but were issued and recognised as eligible tier 1 capital prior to the implementation of CRD IV, can be partially included within AT1 capital ('grandfathering'), until they are phased out altogether by 2022. To the extent these securities no longer qualify as AT1 capital they may nevertheless still qualify as tier 2 capital either under transitional rules for tier 2 securities or on an end point basis.
- Tier 2 (T2) capital largely comprises certain other subordinated debt securities that do not qualify as AT1. They must have an original term of at least 5 years, cannot normally be redeemed within their first 5 years and are phased out as T2 regulatory capital in the final 5 years before maturity. Under transitional rules for capital, securities that do not qualify in their own right as T2 capital, but were issued and recognised as eligible T2 capital prior to the implementation of CRD IV, can be partially included within T2 capital ('grandfathering'), until they are phased out altogether by 2022. Eligible provisions, reflecting the excess of IFRS 9 expected credit losses over corresponding regulatory expected losses, are added back to T2 capital, net of the application of IFRS 9 transitional adjustments.

The Group's transitional capital resources are summarised as follows:

	2019 £m	2018 £m
Common equity tier 1 capital	**8,706**	7,964
Additional tier 1 capital	**2,913**	1,784
Tier 2 capital	**2,288**	3,370
Total capital	**13,907**	13,118

45 Cash flow statements

a Change in operating assets

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Change in financial assets held at amortised cost	**3,660**	4,629	**3,566**	4,120
Change in amounts due from Group undertakings	**(38,602)**	22,798	**(39,020)**	24,669
Change in derivative financial instruments and financial assets at fair value through profit or loss	**(955)**	2,032	**(1,104)**	2,072
Change in other operating assets	**177**	253	**183**	244
Change in operating assets	**(35,720)**	29,712	**(36,375)**	31,105

b Change in operating liabilities

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Change in deposits from banks	**(4,436)**	(275)	**(4,436)**	(275)
Change in customer deposits	**(10,291)**	(9,058)	**(10,317)**	(9,058)
Change in amount due to Group undertakings	**49,849**	(18,802)	**50,213**	(19,924)
Change in debt securities in issue	**(657)**	990	**(484)**	761
Change in derivative financial instruments and financial liabilities at fair value through profit or loss	**1,088**	(823)	**1,134**	(803)
Change in other operating liabilities[1]	**(70)**	231	**59**	105
Change in operating liabilities	**35,483**	(27,737)	**36,169**	(29,194)

1 Includes £9 million (2018: £nil) for the Group and £9 million (2018: £nil) for the Bank in respect of lease liabilities.

c Non-cash and other items

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Depreciation and amortisation	**235**	162	**235**	158
Dividends received from subsidiaries	**–**	–	**(83)**	(126)
Revaluation of investment properties	**8**	–	**–**	–
Impairment charge relating to undrawn balances	**5**	(38)	**5**	(38)
Allowance for loan losses	**445**	232	**595**	257
Write-off of allowance for loan losses, net of recoveries	**(508)**	(386)	**(496)**	(399)
Impairment losses on investments in subsidiaries	**–**	–	**9**	–
Payment protection insurance provision	**963**	185	**964**	185
Other provision movements	**235**	186	**235**	180
Unwind of discount on impairment allowances	**(11)**	(1)	**(15)**	(4)
Foreign exchange element on balance sheet[1]	**494**	(175)	**264**	(177)
Interest expense on subordinated liabilities	**186**	199	**185**	199
Profit on disposal of businesses	**–**	–	**–**	(30)
Other non-cash items	**(16)**	(22)	**(25)**	(23)
Total non-cash items	**2,036**	342	**1,873**	182
Payments in respect of other provisions	**(464)**	(615)	**(455)**	(598)
Payments in respect of payment protection insurance provision	**(759)**	(740)	**(757)**	(736)
Other	**(10)**	6	**(10)**	–
Total other items	**(1,233)**	(1,349)	**(1,222)**	(1,334)
Non-cash and other items	**803**	(1,007)	**651**	(1,152)

1 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.

45 Cash flow statements (continued)

d Analysis of cash and cash equivalents as shown in the balance sheet

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Cash and balances with central banks	**2,492**	2,579	**2,492**	2,579
Less: mandatory reserve deposits[1]	**(1,775)**	(1,738)	**(1,775)**	(1,738)
	717	841	**717**	841
Loans and advances to banks	**311**	471	**307**	471
Less: amounts with a maturity of three months or more and amounts due from fellow Lloyds Banking Group undertakings	**(269)**	(309)	**(269)**	(309)
	42	162	**38**	162
Total cash and cash equivalents	**759**	1,003	**755**	1,003

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.

e Disposal and closure of group undertakings, joint ventures and associates

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Due from fellow group undertakings	**–**	69	**–**	–
Financial assets at fair value through profit or loss	**–**	66	**–**	–
	–	135	**–**	–
Due to fellow group undertakings	**–**	(89)	**–**	–
Other net assets (liabilities)	**–**	1	**–**	–
	–	(88)	**–**	–
Net assets (liabilities) disposed of	**–**	47	**–**	–
Investment in subsidiary disposed of	**–**	–	**–**	17
Profit on sale of business	**–**	–	**–**	30
Cash consideration received on losing control of group undertakings and businesses	**–**	47	**–**	47
Cash and cash equivalents disposed	**–**	–	**–**	–
Net cash inflow	**–**	47	**–**	47

46 Adoption of IFRS 16

The Group adopted IFRS 16 Leases from 1 January 2019 and elected to apply the standard retrospectively with the cumulative effect of initial application being recognised at that date; comparative information has therefore not been restated. Comparative information was prepared in accordance with IAS 17. Under IAS 17, where the Group was lessee it charged operating lease rentals to the income statement on a straight-line basis over the life of the lease.

Operating lease commitments as at 31 December 2018 amounted to £892 million. Lease liabilities amounting to £779 million in respect of leased properties previously accounted for as operating leases were recognised at 1 January 2019. These liabilities were measured at the present value of the remaining lease payments, discounted using the Group's incremental borrowing rate appropriate for the related right-of-use asset as at that date. The weighted-average borrowing rate applied to these lease liabilities was 2.43 per cent. The corresponding right-of-use asset of £748 million was measured at an amount equal to the lease liabilities, adjusted for lease liabilities recognised at 31 December 2018 of £30million. The right-of-use asset and lease liabilities are included within Property, plant and equipment and Other liabilities respectively. There was no impact on shareholders' equity.

In applying IFRS 16 for the first time, the Group has used a number of practical expedients permitted by the standard; the most significant of which were the use of a single discount rate to a portfolio of leases with reasonably similar characteristics; reliance on previous assessments of whether a lease is onerous; and the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease. The Group has also elected not to apply IFRS 16 to contracts that were not identified as containing a lease under IAS 17 and IFRIC 4 *Determining whether an Arrangement contains a Lease*.

47 Future accounting developments

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2020 (including IFRS 3 *Business Combinations* and IAS 1 *Presentation of Financial Statements*). These amendments are not expected to have a significant impact on the Group.

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48 Events since the balance sheet date

Since the balance sheet date there has been a global pandemic from the outbreak of Coronavirus which is causing widespread disruption to financial markets and normal patterns of business activity across world, including the UK. The Directors assess this event to be a non-adjusting post balance sheet event. In view of its currently evolving nature, the Directors are unable to estimate its financial and other effects.

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49 Other information

Bank of Scotland 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.

Bank of Scotland plc's immediate parent undertaking is HBOS plc and its 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.

Subsidiaries and related undertakings

GROUP COMPANIES

In compliance with Section 409 of the Bank Act 2006, the following comprises a list of all related undertakings of the Bank, as at 31 December 2019. The list includes each undertaking's registered office and the share classes in issue.

Subsidiary Undertakings

The Bank directly or indirectly holds 100 % of the share class or a majority of voting rights (including where the undertaking does not have share capital as indicated) in the following undertakings.

Name of undertaking	Notes
Anglo Scottish Utilities Partnership 1	+ *
Automobile Association Personal Finance Ltd	4 iii
Bank of Scotland (B G S) Nominees Ltd	5 *
Bank of Scotland (Stanlife) London Nominees Ltd	5 *
Bank of Scotland Edinburgh Nominees Ltd	5 *
Bank of Scotland Equipment Finance Ltd (in liquidation)	13 iii
Bank of Scotland LNG Leasing (No 1) Ltd (in liquidation)	13 iii
Bank of Scotland London Nominees Ltd	5 *
Bank of Scotland Nominees (Unit Trusts) Ltd	5 *
Bank of Scotland P.E.P. Nominees Ltd	5 *
Bank of Scotland Structured Asset Finance Ltd	1 iii
Bank of Scotland Transport Finance 1 Ltd (in liquidation)	13 iii
Bank of Wales Ltd	2 vi
Barents Leasing Ltd	1 iii
Birmingham Midshires Financial Services Ltd	4 iii
Birmingham Midshires Land Development Ltd (in liquidation)	13 iii
Birmingham Midshires Mortgage Services Ltd (in liquidation)	13 iii
BOS (Ireland) Property Services 2 Ltd	15 iii
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Ltd	4 iii
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Ltd	4 iii
BOS (Shared Appreciation Mortgages (Scotland)) Ltd	4 iii
BOS (Shared Appreciation Mortgages) No. 1 plc	4 iii
	viii #
BOS (Shared Appreciation Mortgages) No. 2 plc	4 iii
	viii #
BOS (Shared Appreciation Mortgages) No. 3 plc	4 iii
	viii #
BOS (Shared Appreciation Mortgages) No. 4 plc	4 iii
	viii #
BOS (Shared Appreciation Mortgages) No. 5 plc	4 iii
BOS (Shared Appreciation Mortgages) No. 6 plc	4 iii
BOSSAF Rail Ltd	1 iii
BOS Personal Lending Ltd	4 i
	ii
British Linen Leasing (London) Ltd	5 iii
British Linen Leasing Ltd	5 iii
British Linen Shipping Ltd	5 iii
Capital 1945 Ltd	2 iii
Capital Bank Leasing 3 Ltd (in liquidation)	13 iii
Capital Bank Leasing 5 Ltd	2 iii
Capital Bank Leasing 9 Ltd (in liquidation)	13 iii
Capital Bank Leasing 12 Ltd	5 iii
Capital Bank Property Investments (3) Ltd	9 iii
Capital Personal Finance Ltd	4 iii
CF1 Ltd (in liquidation)	13 v
	iv #
CBRail S.A.R.L.	8 iii
CF Asset Finance Ltd (in liquidation)	13 iii
Chariot Finance Ltd (in liquidation)	13 iii
First Retail Finance (Chester) Ltd	4 iii
Forthright Finance Ltd	2 iii
Halifax Credit Card Ltd (in liquidation)	13 i
	ii
	ix
Halifax Leasing (June) Ltd (in liquidation)	13 iii
Halifax Leasing (March No.2) Ltd	1 iii
Halifax Leasing (September) Ltd	1 iii
Halifax Loans Ltd	4 iii
Halifax Mortgage Services Ltd	4 iii
Halifax Premises Ltd (in liquidation)	13 iii
Halifax Vehicle Leasing (1998) Ltd	4 iii
HBOS Covered Bonds LLP	4 *
HBOS Social Housing Covered Bonds LLP	2 *
Home Shopping Personal Finance Ltd	4 iii
IBOS Finance Ltd	2 iii
ICC Enterprise Partners Ltd (in liquidation)	12 iii
ICC Equity Partners Ltd (in liquidation)	12 iii
ICC Holdings Unlimited Company	15 iii
Intelligent Finance Financial Services Ltd	4 iii
Intelligent Finance Software Ltd	4 iii
Lex Vehicle Leasing (Holdings) Ltd (in liquidation)	13 i
	ii
	vii
Lex Vehicle Leasing Ltd (in liquidation)	13 iii
Lloyds Bank (Fountainbridge 1) Ltd	5 iii
Lloyds Bank (Fountainbridge 2) Ltd	5 iii
Lloyds Capital GP Ltd	14 iii
Lloyds Hypotheken B.V.	7 iii
Lloyds Secretaries Ltd	1 iii
London Uberior (L.A.S. Group) Nominees Ltd	5 *
Membership Services Finance Ltd	4 iii
NFU Mutual Finance Ltd	2 i
	ii #
	iv
Nordic Leasing Ltd	1 iii
NWS Trust Ltd	5 iii
Ocean Leasing (July) Ltd (in liquidation)	13 iii
Pacific Leasing Ltd	1 iii
Seabreeze Leasing Ltd	1 iii
Seaspirit Leasing Ltd	1 iii
Standard Property Investment (1987) Ltd	5 i
	ii
Standard Property Investment Ltd	16 iii #
Sussex County Homes Ltd	4 iii
The British Linen Company Ltd	5 iii
The Mortgage Business plc	4 iii
Thistle Leasing	+ *
Tower Hill Property Investments (7) Ltd	9 iii #
Tower Hill Property Investments (10) Ltd	9 iii #
Tranquility Leasing Ltd	1 iii
Uberior Nominees Ltd	5 *
Uberior Trustees Ltd	5 *

Subsidiaries and related undertakings

Subsidiary Undertakings (continued)

The Bank has determined that it has the power to exercise control over the following entities without having the majority of the voting rights of the undertakings. Unless otherwise stated, the undertakings do not have share capital or the Bank does not hold any shares.

Name of undertaking	Notes
Addison Social Housing Holdings Ltd	3
Deva Financing Holdings Ltd	10
Deva Financing plc	10
Edgbaston RMBS 2010-1 plc	10
Edgbaston RMBS Holdings Ltd	10
Elland RMBS 2018 plc	10
Elland RMBS Holdings Ltd	10
Housing Association Risk Transfer 2019 DAC	11
Lingfield 2014 I Holdings Ltd	10
Lingfield 2014 I plc	10
Molineux RMBS 2016-1 plc	10
Molineux RMBS Holdings Ltd	10
Penarth Asset Securitisation Holdings Ltd	10
Penarth Funding 1 Ltd	10
Penarth Funding 2 Ltd	10
Penarth Master Issuer plc	10
Penarth Receivables Trustee Ltd	10
Permanent Funding (No. 1) Ltd	10
Permanent Funding (No. 2) Ltd	10
Permanent Holdings Ltd	10
Permanent Master Issuer plc	10
Permanent Mortgages Trustee Ltd	10
Permanent PECOH Holdings Ltd	10
Permanent PECOH Ltd	10
Swan Funding 2 Ltd	3
Syon Securities 2019 DAC	11
Trinity Financing Holdings Ltd	10
Trinity Financing plc (in liquidation)	6

Associated Undertakings

The Bank has a participating interest in the following undertakings.

Name of undertaking	% of share class held by immediate parent company (or by the Company where this varies)	Registered office address
Addison Social Housing Ltd	20%	35 Great St Helen's, London, EC3A 6AP
Connery Ltd	20%	44 Esplanade, St. Helier, Jersey JE4 9WG

* The undertaking does not have share capital
+ The undertaking does not have a registered office
# In relation to Subsidiary Undertakings, an undertaking external to the Group holds shares
(i) A Ordinary Shares
(ii) B Ordinary Shares
(iii) Ordinary Shares
(iv) C Ordinary Shares
(v) N Ordinary Shares
(vi) Ord Stock Units
(vii) Redeemable Preference Shares
(viii) Non-voting Deferred Shares
(ix) C Ordinary Non-voting Shares

Registered office addresses

(1) 25 Gresham Street, London, EC2V 7HN
(2) Charterhall House, Charterhall Drive, Chester, CH88 3AN
(3) 44 Esplanade, St. Helier, Jersey, JE4 9WG
(4) Trinity Road, Halifax, West Yorkshire, HX1 2RG
(5) The Mound, Edinburgh, EH1 1YZ
(6) 40a Station Road, Upminster, Essex, RM14 2TR
(7) Lichtenauerlann 170, 3062ME, Rotterdam, Netherlands
(8) 1A Heienhaff, Senningerberg, L-1736, Luxembourg
(9) Cawley House, Chester Business Park, Chester, CH4 9FB, United Kingdom
(10) 35 Great St. Helen's, London, EC3A 6AP
(11) 5th Floor, The Exchange, George's Dock, IFSC, Dublin 1, Ireland
(12) McStay Luby, Dargan House, 21-23 Fenian Street, Dublin 2, Ireland
(13) 1 More London Place, London, SE1 2AF
(14) 2nd Floor, 21 Palmer Street, London, SW1H 0AD
(15) Suite 6, Rineanna House, Shannon Free Zone, Co. Clare, Ireland
(16) Caledonian Exchange, 19A Canning Street, Edinburgh, EH3 8HE

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