Lloyds Bank Corporate Markets plc

Report and Accounts
2019

Member of Lloyds Banking Group

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Strategic report

The directors present their Strategic report on Lloyds Bank Corporate Markets plc (the Bank) and its subsidiary undertakings (the Group) for the year ended 31 December 2019.

The Bank and the Group provide a wide range of banking and financial services through branches and offices in the UK, the Crown Dependencies, USA, Singapore and Germany. The Bank was established in response to the Financial Services (Banking Reform) Act 2013 for the purpose of carrying on elements of the commercial banking business of Lloyds Banking Group plc (also referred to herein as LBG) along with the banking business of LBG in territories outside the EEA. The Group contributes to the financial results of the Commercial Banking Division of LBG.

Principal activities

Lloyds Bank Corporate Markets plc (LBCM) supports a diverse range of customers and provides a broad range of banking products to help them achieve their financial goals. The Group's revenues are earned through the provision of financing and risk management solutions to commercial customers; and current accounts, savings accounts, mortgages, car finance and personal loans in the Retail market in our Crown Dependencies businesses.

The target market for these products and services in the UK and internationally is made up of large corporates, financial institutions, and retail and commercial customers in the Crown Dependencies, and includes the following product propositions:

– Commercial lending (including fixed rates loans, revolving credit facilities, variable loans and business mortgages)
– Trade and working capital management (including trade services, trade finance, supply chain finance and asset finance)
– Bonds and structured finance (including bonds, structured lending and asset securitisation)
– Risk management (including FX, rates, credit, commodities and liabilities management)
– Retail banking services (including mortgages, personal current accounts, personal loans, investment services and motor finance) in the Crown Dependencies

Key performance indicators

Our strategic purpose as part of LBG is to Help Britain Prosper through operating a responsible business that focuses on delighting our customers and delivering long-term sustainable success.

Our customer focused business model continues to provide a competitive advantage with the diversity and strength of our client franchise enabling scalable business propositions, relative cost efficiencies and sustainable returns on capital deployed. We are developing a culture to attract, retain and develop the right capability for the future. We have a diversified and high quality balance sheet and are Helping Britain Prosper through a simple digitised business underpinned by a strong brand, credit rating and capital position. Our shared service model leverages LBG capabilities to meet the needs of our customers and we are transforming the business to deliver a leading customer experience.

Our focus on delighting our customers is key to the success of our strategy. We measure our success in meeting customer focussed objectives such as customer satisfaction and complaint levels through a range of customer insight and feedback. Our ongoing commitment to treat customers fairly and consistently delivering great service is central to our ways of working.

Other key performance indicators regularly monitored include detailed business performance, appropriate levels of capital, funding and liquidity. Key metrics are noted below in tables 1 and 2.

In addition, the Bank's Board of Directors (the Board) notes the following with regard to strategic progress and indicators of performance:

– Continued investment in a number of areas across the period to benefit both customers and colleagues, including technology in our Crown Dependencies business to enhance capability and grow the commercial franchise.
– Further investment in our Markets business with the enhancement of our e-trading system for FX and Rates bringing 24 hour customer support
– Product development including the launch of buy to let mortgages in the Crown Dependencies and new Trade finance capability in Asia
– The successful creation of our European securities trading company in Frankfurt (Lloyds Corporate Markets Wertpapierhandelsbank GmbH)
– Flagship inaugural Euro Medium Term Note (EMTN) programme providing further diversity and efficiency in our funding base
– Restructure of our Crown Dependencies business to simplify the entity structure and release capital
– Colleague development, learning hours and engagement measured through our annual survey
– Delivery of optimisation initiatives in the year to strengthen our balance sheet

Future developments

Our customer and strategic priorities remain unchanged. Further digitisation will simplify our operating model, increase efficiency and deliver a stronger proposition for customers. We will grow the business in core Retail and Commercial franchises through product and service enhancements; in Markets we will continue to respond to the industry pace of change to remain competitive and meet our customers' evolving needs. Focus continues on having optimal levels of funding, capital and costs to deliver sustainable returns on equity.

Financial performance

Overall, 2019 has seen a solid performance of our diversified business in what have been challenging market conditions. The Board considers the successful development of the business plus its response to market conditions as a key measure of performance in the year.

Relevant business and companies transferred from other parts of LBG during 2018 on a staggered basis and therefore 2018 comparatives are not reflective of a full year's trading. During the year ended 31 December 2019, the Group recorded a profit before tax of £368 million compared with £190 million in 2018. Notwithstanding the shorter prior year comparative, 2019 has seen a resilient performance in challenging market conditions, with good progress made in increasing returns on equity through a combination of income, cost management and disciplined capital deployment.

Total income was £819 million compared to £455 million in 2018, comprising net interest income of £170 million compared to £103 million in 2018, net fee and commission income of £188 million compared to £121 million in 2018 and net trading income of £461 million compared to £231 million in 2018. Operating expenses were £462 million compared to £273 million in 2018, predominantly consisting of management charges relating to the Intra Group Agreement (IGA) and staff costs payable to LBG. A net impairment gain of £11 million compared to £8 million in 2018 was recognised. In 2019, the Group recorded a tax expense of £85 million compared to £30 million in 2018.

Total assets of the Group were £1,190 million higher at £79,661 million at 31 December 2019 compared to £78,471 million at 31 December 2018. Financial assets at fair value through profit or loss increased in the year by £975 million to £18,146 million compared to £17,171 million at 31 December 2018 driven by increases in gilts. Derivative financial instruments increased in the year by £2,969 million to £18,836 million compared to £15,867 million at 31 December 2018. Financial assets at amortised cost decreased to £25,899 million compared to £29,992 million at 31 December 2018, this includes Loans and Advances to Customers of £20,264 million compared to £20,684 million at 31 December 2018. This overall reduction on amortised cost assets mainly relates to a reduction in funds deposited with a fellow LBG company.

Total liabilities of the Group were £75,385 million at 31 December 2019 compared to £74,479 million at 31 December 2018 including a reduction in customer deposits to £24,479 million compared to £26,870 million at 31 December 2018; financial liabilities at fair value through profit or loss of £13,784 million compared to £14,008 million at 31 December 2018 reflecting a broadly flat position on repos year on year; derivative financial instruments of £17,762 million compared to £14,511 million at 31 December 2018 and debt securities in issue of £12,429 million compared to £12,942 million at 31 December 2018. Total equity at the year end was £4,276 million compared to £3,992 million at 31 December 2018. The Group's post-tax return on average total assets increased to 0.32 per cent compared to 0.21 per cent in the year ended 31 December 2018.

The Group's common equity tier 1 capital ratio increased to 14.0 per cent (31 December 2018: 13.7 per cent) and the tier 1 capital ratio increased to 18.6 per cent (31 December 2018: 17.5 per cent), due to the reduction in risk-weighted assets and profits for the period offset by the accrual for foreseeable dividends.

The total capital ratio increased to 22.5 per cent (31 December 2018: 20.9 per cent) largely reflecting the reduction in risk-weighted assets, partially offset by the reduction in tier 1 capital.

Risk-weighted assets reduced by £3,248 million, or 16 per cent, to £16,620 million at 31 December 2019, compared to £19,868 million at 31 December 2018, largely reflecting optimisation activity, change in mix of the portfolio and a reduction in lending balances with Lloyds Bank plc.

Capital position at 31 December 2019
The Group's capital position as at 31 December 2019 is set out in the following section.

Table 1: Capital resources (audited)

	2019 £m	2018 £m
Common equity tier 1		
Shareholders' equity per balance sheet	**3,494**	3,210
Adjustment to retained earnings for foreseeable dividends	**(700)**	–
Cash flow hedging reserve	**(56)**	(5)
Debit valuation adjustment	**(25)**	(71)
Sub-total	**2,713**	3,134
Less: deductions from common equity tier 1		
Prudent valuation adjustment	**(179)**	(199)
Excess of expected losses over impairment provisions and value adjustments	**(16)**	(20)
Securitisation deductions	**(185)**	(191)
Deferred tax assets	**(2)**	(1)
Common equity tier 1 capital	**2,331**	2,723
Additional tier 1 instruments	**757**	757
Total tier 1 capital	**3,088**	3,480
Tier 2 instruments	**645**	672
Total capital resources	**3,733**	4,152
Risk-weighted assets (unaudited)	**16,620**	19,868
Common equity tier 1 capital ratio	**14.0%**	13.7%
Tier 1 capital ratio	**18.6%**	17.5%
Total capital ratio	**22.5%**	20.9%

Table 2: Risk-weighted assets (unaudited)

	2019 £m	2018 £m
Foundation Internal Ratings Based (IRB) Approach	**7,342**	8,287
Retail IRB Approach	**16**	22
Other IRB Approach	**603**	652
IRB Approach	**7,961**	8,961
Standardised Approach	**2,087**	3,929
Total credit risk	**10,048**	12,890
Counterparty credit risk	**3,466**	3,582
Credit valuation adjustment risk	**313**	397
Operational risk	**1,189**	1,378
Market risk	**1,588**	1,607
Underlying risk-weighted assets	**16,604**	19,854
Threshold risk-weighted assets	**16**	14
Total risk-weighted assets	**16,620**	19,868

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 the following statement 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 Directors' report on page 9 and the Corporate Governance Statement on pages 9 and 10.

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), the following statement also provides details of how the directors have engaged with and had regard to the interests of key stakeholders. The Bank is a subsidiary of Lloyds Banking Group plc (LBG), and as such adopts many of the processes and practices of LBG, which are further referred to in this statement where relevant.

The directors acknowledge that one of the primary responsibilities of the Board is to ensure the strategy of the Bank, as aligned to that of LBG, achieves long-term success and generates sustainable returns, central to which is ensuring engagement with stakeholders, and considering in all instances the long-term implications of decisions made, acting at all times to maintain the highest possible standards of conduct. This approach has during the course of the year been central to the activities of the directors, as discussed below.

Customers

The directors ensure the Bank works towards achieving its customers ambitions, treating customers fairly, and making it easy for customers to find, understand and access products that are suitable for them. To ensure directors truly understand the needs of customers, every opportunity is taken to consider direct customer feedback and related management information, including as part of the directors' strategic decision making process. The Bank proactively engages with customers by conducting Customer feedback surveys, including the Client 360 Feedback Programmes. The directors have also worked to ensure the business of the Bank is undertaken in line with the objectives of LBG's annually agreed customer plans, with the directors regularly reviewing customer complaints to understand areas where improvements can be made in responding to complaints. LBG regularly benchmarks its performance and the performance of its subsidiaries, including the Bank, amongst its customers. LBG uses this insight along with a range of internal and external research to ensure ongoing improvement in customer experience. The directors ensure the Bank plays an active part in LBG's wider customer ambitions, as acknowledged in the Bank's strategy, and where appropriate during the course of the year has included the ongoing development of market leading digital propositions, more personalised customer propositions and better experience for customers across all channels.

Shareholders

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

Colleagues

The Bank's approach in respect of employees, including their engagement, is part of that of LBG, where colleagues take pride in working for an inclusive and diverse organisation which continues to work towards building a culture in which everyone feels included, empowered and inspired to do the right thing for customers. In 2019, the LBG Board agreed how LBG, including the Bank, would engage with the workforce. The definition of 'workforce', as agreed by the LBG Board is permanent employees, contingent workers and third-party suppliers that work on LBG premises delivering services to customers and supporting key business operations. A LBCM workplan was discussed and agreed in April 2019 and as a result the Board now receives quarterly updates which comprise a summary of LBCM engagement activity with colleagues and key themes raised by colleagues and trends on people matters, including for example absence or attrition. In addition the Board receives regular updates on colleague matters. On at least an annual basis, the LBG CEO and the Chair of the LBG Remuneration Committee meet with recognised unions.

As well as its own engagement survey, of which the Bank is part, LBG takes part in the Banking Standards Board assessment on a yearly basis, which provides member firms with the evidence, support and challenge to help them achieve and maintain high standards of behaviour and competence both individually and collectively. There are five parts to the assessment: an online employee survey, a set of Board questions, interviews with executive directors, interviews with non-executive directors and employee focus groups.

The Board considers that the above arrangements are effective in giving the Board an understanding of the views of the workforce as they generate feedback, themes and viewpoints which the Board discuss and debate to encourage meaningful dialogue between the LBG Board, the Board and the workforce.

Communities and the environment

The directors acknowledge that the Bank, as part of one of the largest retail and commercial financial service providers in the UK, has responsibilities to invest in the communities in which it operates, to help them prosper economically and build social cohesion by tackling disadvantage. The Bank participates in related LBG initiatives, with the directors ensuring the Bank plays an appropriate role in LBG's related Helping Britain Prosper Plan. Further information in respect of the LBG approach to engaging with and contributing to the communities in which it operates is included within the Strategic report within the LBG Annual Report and Accounts for 2019. Additional information on LBG's Helping Britain Prosper Plan is available on the LBG website.

The Responsible Business Committee of the Board of LBG is responsible for overseeing LBG's performance, including that of the Bank, as a Responsible Business, by providing oversight of and support for LBG's strategy and plans for embedding responsible business as part of both LBG's and the Bank's purpose to Help Britain Prosper. Ongoing focus on three key areas aligned to LBG's Bank of the Future strategy has been a priority this year. These included consideration of the progress of the Lloyds Bank Academy and the external initiative 'future.now', both designed to boost digital skills in the UK. Progress against agreed sustainability strategy was considered, where consistent progress was made in achieving targets such as providing support for the EV1000 electric vehicles initiative. Consideration was also given to the relationships between LBG and its charitable foundations, in particular the work they do in the communities in which LBG and the Bank operate. Further information in respect of LBG's and the Bank's Responsible Business activities is included on pages 26 to 35 of the LBG Annual Report and Accounts for 2019, available on the LBG website, along with further discussion of the work of LBG's Responsible Business Committee.

Suppliers

The Bank's approach to external supplier management makes use of that of LBG, which works with around 3,100 active suppliers of varying sizes, most in professional services sectors such as IT, cyber, operations, management consultancy, legal, HR, marketing and communication. The supply chain is crucial to the way the Bank and LBG serves its customers, and through it the reach is considerable.

The Bank and LBG seek to improve the experience of suppliers, with feedback regularly sought on related assurance processes to ensure continued improvement in the process. Suppliers are also encouraged to express their satisfaction or otherwise, and have access to LBG and the Bank's whistleblowing service.

In 2019 LBG's supplier expenditure was £5.9 billion, with 95.5 per cent of third party suppliers being located in the UK. Importance is placed on having the right supplier framework to operate responsibly. LBG's Sourcing & Supply Chain Management Policy applies to all businesses, divisions, and subsidiaries of LBG, including the Bank, with the directors assuming ultimate responsibility for its application as relevant to the Bank. This Policy has been designed to assist in managing the inherent risk in outsourcing services, and in dealing with third party suppliers. Suppliers are required to adhere to relevant LBG policies and comply with LBG's Code of Supplier Responsibility which can be found on the LBG website. This defines expectations for responsible business behaviour, underpinning the efforts of the Bank and LBG to share and extend good practice. All material contracts are subject to rigorous cost management governance with regular review of key supplier risks.

Regulators

The Bank and its directors have a strong, open and transparent relationship with relevant regulators and other authorities and liaise regularly both directly and as part of LBG to ensure the business is aligned to the evolving regulatory framework. Key areas of focus have included ensuring robust prudential standards and supervision arrangements are in place, ensuring the fair treatment of customers, adapting to changes in regulatory requirements, recovery and resolution and preparations for the UK's withdrawal from the EU.

The Board receives regular updates on regulatory interaction, providing a view of key areas of focus, alongside progress made addressing regulatory actions and current enforcement activity. During 2019 the Bank and LBG colleagues had regular meetings with the regulators, representing the interests of the Bank as required. Engagement continues with the regulators through proactive meetings to discuss various key themes such as achieving a customer centric culture, transformation and change, operational and financial resilience and credit risk. The status of regulatory relationships continue to be closely monitored, enhancing proactive engagement across key regulatory changes and areas of focus. The approach of LBG, including that of the Bank, to managing regulatory change is discussed further on page 11 of the LBG Annual Report and Accounts for 2019 available on the LBG website.

Principal risks and uncertainties

The most significant risks that could impact LBCM Group's ability to deliver long-term strategic objectives, and our approach to managing each risk, are detailed below. These principal risks and uncertainties are reviewed and reported to the Board Risk Committee regularly.

There is uncertainty surrounding both UK and global political and macroeconomic developments. The potential impacts of these external factors have been considered in all principal risks to ensure they are monitored and appropriately mitigated where possible.

As part of our ongoing assessment of the potential implications of the UK leaving the European Union, LBCM Group continues to consider the potential impact to its customers, colleagues and products in addition to legal, regulatory, tax, financial and capital implications.

Additionally, the LBCM Group is transitioning from IBORs to Alternative Risk Free Reference Rates as widely used benchmark rates, such as the London Interbank Offered Rate (LIBOR), have been subject to increasing regulatory scrutiny, with regulators signalling the need to use alternative benchmark rates. As a result, existing benchmark rates may be discontinued or the basis on which they are calculated may change. Uncertainty as to the nature of such potential changes may adversely affect the value of a broad array of financial products, including any LIBOR-based securities, loans and derivatives. This may impact the availability and cost of hedging instruments and borrowings. Any changes could have important implications for our customers, for example: necessitating amendments to existing documents and contracts; and differential in performance of benchmark rates and financial products which reference them. The LBCM Group is working closely with Lloyds Banking Group on the transition away from IBORs.

In the context of operational resilience, LBCM Group is assessing the risks associated with the current global health issue Covid-19 and continues to analyse the impacts on its customers and colleagues. However, it is difficult at this stage to quantify risks and the degree to which they might crystallise and impact LBCM Group customers through UK trading links or global supply chains. In addition, Covid-19 could have an adverse impact across risks including our credit portfolio, operational risk, people, capital, funding and liquidity.

Credit risk

The risk that parties with whom the Group has contracted fail to meet their financial obligations (both on and off balance sheet). Observed or anticipated changes in the economic environment could impact profitability due to an increase in delinquency, defaults, write-downs and/or expected credit losses.

Key mitigating actions

- Credit policy, incorporating prudent lending criteria, aligned with the LBCM Board-approved risk appetites, to manage risk effectively
- Robust risk assessment and credit sanctioning to ensure we lend appropriately and responsibly
- Extensive and thorough credit processes and controls to ensure effective risk identification, management and oversight
- Effective governance processes delivered by the shared service and supported by independent credit risk assurances
- Early identification of signs of stress leading to engagement with the customer

Regulatory and legal risk

The risk arising from the failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements, leading to customer detriment, financial penalties, regulatory censure, criminal or civil enforcement action.

Key mitigating actions

- The LBCM Board has established a risk appetite and metric for regulatory and legal risk
- Effective, well established compliance and legal risk management policies and procedures which ensure appropriate controls and systems are in place to comply with applicable laws, rules and regulations
- Robust framework and processes in place to monitor on-going compliance with new legislation
- Continued investment in people, processes, training and IT to assess impact and help meet our legal and regulatory commitments
- Effective engagement with regulatory authorities and industry bodies on forthcoming regulatory changes, market reviews and investigations
- Effective mechanisms in place to identify, assess and monitor risks, with appropriate oversight and escalation routes in place
- Conduct on-going horizon scanning to identify and address changes on regulatory and legal requirements

Conduct risk

The risk of 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.

Key mitigating actions
- Conduct policies and procedures are in place to ensure appropriate controls and systems that deliver fair customer outcomes and support market integrity and competition requirements
- Conduct risk appetite metrics provide a granular view of how our products and services are performing for customers through the customer lifecycle
- Product approval, continuous product review processes and customer outcome testing (across products and services) supported by conduct management information
- Root cause analysis and clear customer accountabilities for colleagues, with rewards driven by customer-centric metrics
- Further enhancements and embedding of our framework to support all customers, including those in vulnerable circumstances
- Achieve our values-led culture through a focus on our behaviours to ensure we are transforming our Group culture for success in a digital world. This is supported by strong direction and tone from senior executives and the Board
- Review and oversight of thematic conduct agenda items at senior committees, ensuring holistic consideration of key conduct risks
- Robust recruitment and training, with a continued focus on how the LBCM Group manages colleagues' performance with clear customer accountabilities
- Ongoing engagement with third-parties involved in serving the LBCM Group's customers to ensure consistent delivery

Operational risk: overall
The risk of inadequate or failed internal processes, people, systems or from external events leading to loss.

Key mitigating actions
- Through Lloyds Banking Group, continued investment in the LBCM Group's control environment, with an emphasis on automated preventative and real-time detective controls
- Deployment of enhanced cyber controls to detect, protect against and respond to threats to the confidentiality or integrity of information assets, or the availability of systems, and to ensure effective third-party assurance
- Enhancing technology infrastructure and the resilience of systems that support critical business processes
- Working with industry bodies and law enforcement agencies to identify and combat fraud and money laundering

Operational risk: shared services model (SSM)
Lloyds Banking Group's chosen Ring-fencing Operating Model introduces residual risk for the LBCM Group in the execution of that model as a Shared Service Recipient. This includes: Internal Service Provision Risk, Business Process Risk (i.e. non-adherence to key processes), Information Security & Cyber Risk, Fraud and Financial Crime Risk and Operational Risk around business resilience, change activity and sourcing.

Key Risks include
- Key reliance on the SSM increases the prominence of Internal Service Provision Risk
- Business Process Risk (i.e. non-adherence to key processes, including those relating to Market, Operational, Capital, Credit and Funding & Liquidity Risk)
- Information Security & Cyber Risk including access management, records, data protection and cyber
- IT Systems Risk due to reliance on Shared Service from Group IT
- Reliance on the SSM to operate key controls designed to detect and prevent fraud and financial crime
- Operational Risk around business resilience, change activity and sourcing

Key mitigating actions
The LBCM Group has arrangements in place to assess, monitor and take action on risks arising from the Shared Services Model. These arrangements include:

- Service Performance & Reporting to ensure that Management Information is provided to the LBCM Group Executive to monitor and respond to the effectiveness of the service provision
- Service Agreements in the form of legally binding Intra-Group Agreements (IGAs) are in place to ensure required standard for services
- Service Governance arrangements are in place to ensure that LBCM can manage, monitor and escalate service risks to relevant Boards
- Service Audit rights are incorporated within the IGAs, allowing LBCM to audit the services provided by Lloyds Banking Group

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

Key mitigating actions
The LBCM Group takes many mitigating actions with respect to People risk. Key areas of focus include:

- 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 the LBCM 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
- Managing organisational capability and capacity to ensure that we have the right skills and resources to meet our customers' needs and deliver our strategic plan
- Maintain effective remuneration arrangements to ensure they promote an appropriate culture and colleague behaviours that meet customer needs and regulatory expectations
- Ensuring colleague wellbeing strategies and support are in place to meet colleague needs, and that the skills and capability growth required to build a workforce for the 'Bank of the Future' are achieved
- Ensuring compliance with legal and regulatory requirements related to SM&CR, embedding compliant and appropriate colleague behaviours in line with Group policies, values and its people risk priorities
- Key people resources provided under the model are managed by a People Services Agreement (PSA)

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

Key mitigating actions
- A comprehensive capital management framework that includes setting of capital risk appetite and dividend policy
- Close monitoring of capital and leverage ratios to ensure we meet regulatory requirements and remain within Board risk appetite and deploy capital resources efficiently

- Comprehensive stress testing analyses in place to evidence capital adequacy
- Maintaining a recovery plan setting out a range of potential mitigating actions that could be taken in response to a stress

Funding and liquidity risk
The risk that we do not have sufficiently stable and diverse sources of funding or financial resources are insufficient to meet commitments as they fall due.

Key mitigating actions
- Hold a liquidity buffer to cover potential cash and collateral net outflows calibrated to support strategic and operational needs as well as regulatory requirements
- Undertake daily monitoring against a number of market and entity specific Early Warning Indicators complemented with stress testing analysis
- Maintain a Contingency Funding Plan detailing actions and strategies available in stressed conditions
- Diversified funding sources including LBCM Euro Medium Term Notes programme

Governance risk
The risk that our organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively. Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from embedding the requirements arising from the implementation of Ring-Fencing legislation in January 2019 and the continuing evolution of the Senior Manager & Certification Regime (SM&CR), including incorporating Senior Manager Function allocation for Financial Risks arising from Climate Change.

Key mitigating actions
The LBCM Group's Enterprise Risk Management Framework (ERMF) establishes robust arrangements for risk governance, in particular by:

- 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
- On-going monitoring of governance arrangements and key activities to ensure appropriateness, and compliance against regulatory requirements this includes, but is not limited to, the Corporate Governance Framework (the Board and its Committees and the Executive Committees), Shared Service and Credit Governance
- Governance Risk profile and performance against key metrics are monitored regularly and reported through the Risk appetite Dashboard and consolidated Risk Report to LBCM Risk Committee, Board Risk Committee and the Board
- Supporting a consistent approach to Lloyds Banking Group-wide behaviour and risk decision-making through the adoption of the Group policy framework
- Effective implementation of the ERMF mutually reinforces and is reinforced by the Group's risk culture, which is embedded in its approach to recruitment, selection, training, performance management and reward

Market risk
The risk that our capital or earnings profile is affected by adverse market rates, in particular changes in interest and foreign exchange rates (and their volatilities), inflation rates, commodity prices and credit spreads through activity in the banking and markets businesses.

Key mitigating actions
- Undertaking regular monitoring of market risk positions versus limits and triggers to ensure they remain within limits which are calibrated in line with risk appetite
- Mitigating actions vary depending on exposure but, in general, seek to reduce risk in a cost effective manner including the externalisation to financial markets where market liquidity allows
- Structural hedge programmes implemented to manage liability margins and margin compression

Model risk
The risk of financial loss, regulatory censure, reputational damage or customer detriment from deficiencies in developing, applying and operating models and rating systems.

Key mitigating actions
A comprehensive model risk management framework including:

- Defined roles and responsibilities, with clear ownership and accountability
- Principles regarding the requirements of data integrity, development, validation, implementation and on-going maintenance
- Regular model monitoring
- Independent review of models
- Periodic validation and re-approval of models

Climate change risk
The key risks associated with climate change are physical risks arising from climate and weather-related events, and transition risks, which are the financial risks resulting from the process of adjustment towards a lower carbon economy. Climate change therefore manifests itself across multiple risk types e.g. credit, market, conduct and operational. For example, physical and transition risk, the impairment of asset values, may impact the creditworthiness of our clients, and in currently profitable business deteriorating over the term of agreed facilities. The focus on these risks by key stakeholders including businesses, clients and investors, governments and regulators is aligned to the evolving societal, regulatory and political landscape.

There also remains a risk that campaign groups or other bodies could seek to take legal action (including indirect action) against LBCM, Lloyds Banking Group and/or the financial services industry for investing in or lending to organisations that they deem to be responsible for, or contributing to, climate change.

Key mitigating actions
- We have taken a strategic approach to align with the UK Government's Clean Growth Strategy and have committed to adopting the approach set out by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) by 2022, when full disclosure is expected
- The LBCM Chief Risk Officer (CRO) has assumed responsibility for identifying and managing the risks arising from climate change in LBCM
- We are integrating risk management of financial risks posed by climate change through our existing enterprise risk management framework, including our policies, risk appetite and controls
- We have conducted scenario analysis across our business to inform our disclosures, including the ICAAP and the Biennial Exploratory Scenario
- We continue to identify new opportunities to support customers and clients and to finance the UK's transition to a lower carbon economy

Data risk
The risk of LBCM failing 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 LBCM and mistrust.

Key mitigating actions
- Introducing advanced data management practices, based on Group-wide standards, data-first culture and modern enterprise data platforms, supported by a simplified modern IT architecture
- Ensuring that risks are identified, measured, managed, monitored and reported using the risk and control self-assessment process
- Employing the infrastructure delivered via the General Data Protection programme
- Developing capability by investing in professional training for data privacy managers
- Enhancing assurance over third party suppliers
- Improving controls and processes for data retention and destruction

Operational resilience risk
The risk that LBCM fails to design resilience into business operations, underlying infrastructure and controls (people, process, technical) to withstand external or internal events that could impact the continuity of operations or alternatively the failure to respond to events in a way which meets stakeholder expectations and needs when the continuity of operations is compromised.

Key mitigating actions
- Designing resilience into LBCM's operations to enable it to be able to withstand and recover from unexpected events
- Identification of its Critical Business Processes
- Setting recovery targets for those processes in line with regulatory guidance
- Ensuring it has resilience capability for those services
- Testing that capability regularly
- Ensuring that the operational resilience risk profile needs are reassessed and prioritised in line with strategic change
- Setting (and operating within) the Board level risk appetite

Change / execution risk
The risk that, in delivering its change agenda, LBCM fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within LBCM's risk appetite.

Key mitigating actions
The Group takes a range of mitigating actions with respect to Change and Execution risk. These include the following:

- Setting (and operating within) the Board level risk appetite for Change and Execution risk. The Board establishes a LBCM wide risk appetite and metric for Change and Execution risk
- Ensuring compliance with 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 LBCM risk appetite
- Assessment by the business of the potential impacts of undertaking any change activity on its ability to execute effectively, and the potential consequences for the existing risk profiles
- Implementation of effective governance and control frameworks to ensure the adequacy of controls to manage the change activity and act to mitigate the change/execution risks identified
- Escalation of events related to change activities to ensure that they are managed appropriately in line with risk framework guidance

Strategic risk
The risk which results from incorrect assumptions about internal or external factors, inappropriate business plans, ineffective business strategy execution, or failure to respond in a timely manner to changes in the regulatory, macroeconomic or competitive environments.

Key mitigating actions
LBCM follows the Group approach to manage strategic risk, including:

- 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
- Continued focus on increasing the efficiency of the business' operations to ensure investment capacity, responsiveness and effectiveness to respond to external trends
- Development of a compelling colleague proposition to continue to attract talent to the 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 35 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
- 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.

On behalf of the Board

Eduardo J Stock da Cunha
Director
Lloyds Bank Corporate Markets plc
25 March 2020

Directors' report

The directors present their annual report and audited consolidated financial statements for the year ended 31 December 2019.

Results
The consolidated income statement on page 23 shows a statutory profit before tax from continuing operations for the year ended 31 December 2019 of £368 million (2018: £190 million).

Dividends
During the year the Bank paid no dividends (2018: £nil). The directors have not recommended a final dividend for the year ended 31 December 2019. In March 2020, the directors approved the payment of an interim dividend of £700 million, which will be paid by the end of April 2020.

Post balance sheet events
Details of events since the balance sheet date are set out in note 38.

Going concern
The going concern of the Bank and the Group is dependent upon successfully maintaining adequate levels of capital and funding. 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 position set out in the Strategic report on pages 2 to 8 and additionally have considered projections for the Bank's and the Group's capital and funding positions. The directors conclude that the Bank and the Group have adequate resources to continue in operational existence for a period of at least 12 months from the date of the approval of the financial statements and therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Corporate governance report
Approach to corporate governance
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 and Group has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the Principles). The following section explains the Bank's approach to corporate governance, and its application of the Principles.

Fundamental to the Bank and Group's strategy are high standards of corporate governance. A Corporate Governance Framework is in place for the Bank, which sets the approach and applicable standards in respect of the Bank's corporate governance arrangements whilst addressing the matters set out in the Principles.

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, and the governance requirements of the operation of the Bank as an entity outside of Lloyds Banking Group's Ring Fenced Bank. 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.

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 LBG, and overseeing delivery against it. The Bank's strategy is discussed further in the Strategic report on pages 2 to 8. The Board also assumes responsibilities for setting the culture, values and wider standards of the Bank, within the equivalent standards set by LBG.

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 closely align to those of LBG, which are discussed in more detail on page 3 of the LBG Annual Report and Accounts for 2019.

Principle two – Board composition
The Board is chaired by a Non-Executive member of the LBG Board and contains a balance of independent Non-Executive Directors, Group executives (serving as Non-Executives) and Executive Directors. This composition supports its legal and regulatory requirements for independent decision making within the overall framework of Group policies and controls.

There were a number of changes to the Board during the year and since the year end, all of which were overseen by the Nomination and Governance Committee. Philip Piers resigned as Chief Financial Officer and Executive Director of the Bank on 31 January 2019 and was succeeded by Christopher Edis. In November 2019, Mark Grant announced his intention to retire as Chief Executive Officer and was succeeded by Eduardo Stock da Cunha on 1 February 2020.

The Nomination and Governance Committee led a thorough selection and recruitment process to identify and assess candidates. Chris and Eduardo were selected on the basis of their strong banking experience and skills and bring a wealth of experience to the Bank. Philip and Mark were crucial members of the team that helped establish the Bank and left with the Board's thanks and best wishes for the future.

Additionally the Nomination and Governance Committee oversaw the planned transition of the Senior Independent Director role from Lord Blackwell, LBG Chairman to John Owen with effect from 31 January 2020. John's breadth and depth of experience make him ideally suited to the role of Senior Independent Director.

The Nomination and Governance Committee continues to keep under review, on an ongoing basis, the structure, size and composition of the Board and its committees, making recommendations to the Board as appropriate. Consideration is given to the need to ensure the appropriate mix of knowledge, skills and experience, and diversity.

The Board has adopted the LBG Board Diversity Policy and LBG Board Diversity Objectives as applicable to the Bank reflecting the relative size of the Board. The Board is committed to maintaining at least two female board members so long as the board size is eight directors. Further, the Board supports the overall aspirations of the Hampton-Alexander and Parker Review goals reflecting that the Bank is a subsidiary and not a listed entity. The Board will take opportunities to increase the number of female board members over time where this is consistent with other skills and diversity requirements and is proportionate to the size of the Board and the Bank.

Reflecting the size and complexity of the business, the Board has established a committee structure comprising a Board Risk Committee, Audit Committee, Remuneration Committee and Nomination and Governance Committee. The committees 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 each 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 Board has established and maintains corporate governance practices that provide clear lines of accountability and responsibility to support effective decision-making though the Corporate Governance Framework. This also helps clarify the relationship between the Bank and its parent company in order to deliver long-term sustainable success. 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 LBG. Consideration is given to strategic opportunities, and the Board's annual cycle of meetings includes sessions dedicated to debating strategic priorities, as well as one offsite meeting focused on strategy.

The Board is also responsible for the long term sustainable success of the Bank, ensuring it generates value for its shareholder and delivers a positive contribution to society. The Board agrees the Bank's culture, purpose, values and strategy within those set by LBG, and sets expectations for risk management, financial performance and reporting. The specific aims and objectives of the Board are formalised within the Bank's Corporate Governance Framework, which also set out the key decisions and matters reserved for the Board's approval.

Strong risk management is central to the Bank's strategy along with a robust risk control framework which acts as the foundation for sustainable business growth. The Board agrees the Bank's risk appetite, within the overarching risk appetite of LBG, and monitors the effectiveness of risk management with the support the Board Risk Committee. Board level engagement, coupled with the direct involvement of senior management ensures that escalated risk 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 LBG, and 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 5 to 8.

Principle five – remuneration
The Remuneration Committee of the Board, in conjunction with the Remuneration Committee of LBG (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, ranging from the remuneration of directors and members of the Executive to that of all other colleagues employed by the Bank. This includes 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.

Principle six – stakeholders
The Bank as part of LBG operates under LBG'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 LBG's Helping Britain Prosper plan, in which the Bank participates, which seeks to gather stakeholder views through a dedicated materiality study, as overseen by LBG's Responsible Business Committee.

In 2019, the Responsible Business Committee determined that the Bank and LBG 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 workforce, as a key stakeholder, includes the Bank's permanent employees, contingent workers and third-party suppliers that work on LBG and the Bank's premises delivering services to customers and supporting key business operations. This also includes LBG colleagues providing services to the Bank under the Shared Service Model. The Board's approach to workforce engagement includes an annual programme of engagement activity and oversight of clear policies on remuneration structures and practices that take account of the broader operating context, including the pay and conditions of the wider workforce and the Bank's response to matters such as any gender pay gap.

Directors
The names of the current directors are shown on page 14. Changes to the composition of the Board since 1 January 2019 up to the date of this report are shown in the table below:

	Joined the Board	Resigned from the Board
Philip J Piers		resigned 31 January 2019
Christopher J K Edis	appointed 1 February 2019	
Mark A Grant		resigned 31 January 2020
Eduardo J Stock da Cunha	appointed 1 February 2020	

Appointment and retirement of directors
The appointment 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.

Directors' report

Information included in the Strategic report incorporated by reference
The following additional information forms part of the Directors' report, and is incorporated by reference.

Content	Pages
Engagement with colleagues	page 4
Engagement with customers, suppliers and others	pages 4 to 5
Principal risks and uncertainties	pages 5 to 8

Directors' indemnities
The directors of the Bank, including the former directors, have entered into individual deeds of indemnity with LBG which constitutes 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the directors who joined the Board during 2019 and 2020. Directors no longer in office but who served on the Board at any time in the financial year had the benefit of this deed of indemnity during that period of service. The indemnity remains in force for the duration of a director's period of office. The deeds indemnify the directors to the maximum extent permitted by law. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

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 8.

Information about share capital is shown in note 26 on page 60. The Bank is a wholly owned subsidiary of Lloyds Banking Group 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.

Directors' interests
The directors do not have any direct interest in the shares of the Bank. Lord Lupton is also a director of LBG. Lord Lupton's interest in shares of LBG is shown in the report and accounts of that company.

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 continuing duty to notify the Chairman and the Company Secretary as soon as they become aware of actual or potential conflict situations. Changes to the 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.

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 this position. The Board has authorised the potential conflicts and requires Lord Lupton to recuse himself from discussions, should the need arise.

Andrew McIntyre is Non-Executive Director, Senior Independent Director and Chair of the Audit and Risk Committee of C. Hoare & Co., a UK regulated private bank; a member of a Financial Reporting Council (FRC) sub-committee called the Financial Reporting Review Panel (FRRP); Non-Executive Director, Chair of Audit Committee and Chair of Ethics and Culture Committee of National Bank of Greece S.A; and has a continuing financial relationship with EY, as a former partner of the firm, in the form of a fixed annuity. The Board has recognised that potential conflicts may arise in relation to these positions, and the continuing financial relationship with EY. The Board has authorised the potential conflicts and requires Andrew McIntyre to recuse himself from discussions, should the need arise.

John Cummins is Managing Director of Future Cities (formerly Urban Renewal and Clean Energy) and interim acting Director of Regeneration, Legal and General Finance plc, director of Legal and General Finance plc and holds a number of director appointments with Legal and General Capital plc related entities. He has been appointed director and trustee of Centre for Cities, a charitable company limited by guarantee set up as a think tank to improve the performance of UK city economies and conduct research into urban matters. In addition, John Cummins has personal investments in a Fintech company, Shieldpay, a developer and supplier of secure anti-fraud payment systems to banks and other organisations; and Auden Group Limited, a social lending company. The Board has recognised that potential conflicts may arise as a result of these positions. The Board has authorised the potential conflicts and requires John Cummins to recuse himself from discussions, should the need arise.

Jennifer Tippin is Group People and Productivity Director for LBG and is a member of the Group Executive Committee (GEC). This role is a permitted interest under the Bank's articles of association but for the sake of good order the Board has authorised the potential conflicts that may arise as a result of this role and requires Jennifer Tippin to recuse herself from discussions, should the need arise. Jennifer Tippin does not act as a representative of the Group shareholder in her role as a Non-Executive Director on the Board. Jennifer Tippin has been appointed with effect from 1 March 2020 as Non-Executive Director and Member of the Remuneration and Nomination Committee of Morgan Sindall Group plc. The Board has authorised the potential conflicts and requires Jennifer Tippin to recuse herself from discussions should the need arise.

Carla Antunes da Silva is Group Strategy, Corporate Ventures and Investor Relations Director for LBG and is an attendee of the GEC. This role is a permitted interest under the Bank's articles of association but for the sake of good order the Board has authorised the potential conflicts that may arise as a result of this role and requires Carla Antunes da Silva to recuse herself from discussions, should the need arise. Carla Antunes da Silva does not act as a representative of the Group shareholder in her role as a Non-Executive Director on the Board.

Branches, future developments and financial risk management objectives and policies
The Bank and the Group provides a wide range of banking and financial services through branches and offices in the UK, Singapore, USA, Germany and the Crown Dependencies. 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 26. This information is incorporated into this report by reference.

The Bank did not issue share capital and did not repurchase any of its own shares during the year. 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.

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 powers include those in relation to the issue or buy back of the Bank's shares. Lloyds Bank Corporate Markets plc is a public company limited by shares.

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
The Bank did not undertake any research and development activities during the year.

Employees
The Group employed an average of 1,196 colleagues (note 7) during 2019 (2018: 624). This represents colleagues based in Singapore, USA, Germany and the Crown Dependencies. UK-based colleagues are employed through other LBG companies and costs recharged via the IGA. Information concerning the employees of Lloyds Banking Group is available in the annual report and accounts of LBG.

As part of LBG, the Bank is moving the debate on from accommodating disabilities, to developing talent and careers. The Bank supports colleagues who have disclosed a disability in a range of ways. The Bank ensures full and fair consideration to applications from people with disabilities, and offers bespoke training, career development, promotions and adjustments for colleagues and applicants with disabilities, including those who became disabled while employed. LBG holds a Business Disability Forum Gold Standard, and Disability Confident Leader status with the Department for Work and Pensions. In July LBG received the National Autistic Society's Autism Friendly Award, marking our commitment to become the UK's first autism friendly bank for customers.

Significant contracts
The Group has a shared service contract with Lloyds Bank plc for the provision of services (note 7).

Details of related party transactions are set out in note 30.

Statement of directors' responsibilities in respect of the financial statements
The directors are responsible for preparing the Report & Accounts and the financial statements in accordance with applicable law and regulation.

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

- select suitable accounting policies and then apply them consistently
- state whether applicable IFRSs as adopted by the European Union have been followed for the Group financial statements and IFRSs as adopted by the European Union have been followed for the Bank financial statements, subject to any material departures disclosed and explained in the financial statements
- make judgements and accounting estimates that are reasonable and prudent
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Bank will continue in business

The directors are also responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank 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.

The directors of the ultimate parent company are responsible for the maintenance and integrity of the ultimate parent company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmations
In the case of each director in office at the date the Directors' Report is approved:

- so far as the director is aware, there is no relevant audit information of which the Group and Bank's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Group and Bank's auditors are aware of that information.

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

Directors' report

A resolution will be proposed at the 2020 annual general meeting to re-appoint PricewaterhouseCoopers LLP as auditors. The Bank's Audit Committee is satisfied that the external auditors remain independent and effective.

The financial statements were approved by the Board and signed on its behalf by:

Christopher J K Edis
Director
25 March 2020

Lloyds Bank Corporate Markets plc
Registered in England & Wales
Company Number 10399850

Directors

John J Cummins *Non-Executive Director*

Eduardo J Stock da Cunha *Executive Director and Chief Executive Officer*

Christopher J K Edis *Executive Director and Chief Financial Officer*

Lord Lupton CBE *Non-Executive Director and Chairman*

Andrew J McIntyre *Non-Executive Director*

John S W Owen *Non-Executive Director and Senior Independent Director*

Carla A S Antunes da Silva *Non-Executive Director*

Jennifer L Tippin *Non-Executive Director*

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 Lloyds Bank Corporate Markets 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 Lloyds Banking Group plc; 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 Lloyds Banking Group plc; 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 Lloyds Banking Group plc; 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 LLOYDS BANK CORPORATE MARKETS PLC

Report on the audit of the financial statements

Opinion

In our opinion, Lloyds Bank Corporate Markets plc's group ("the Group") financial statements and 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.

We have audited the financial statements, included within the Report and Accounts (the "Annual Report"), which comprise: the Group and Bank balance sheets as at 31 December 2019; the Group consolidated income statement and the Group and Bank statements of comprehensive income, the Group and Bank cash flow statements, and the Group and Bank statements of changes in equity 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 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.

Other than those disclosed in note 7 to the financial statements, we have provided no non-audit services to the Group in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Context

The Group operates across a number of territories including the UK, the Crown Dependencies, Germany, Singapore and the USA.

The Bank operates across a number of territories including the UK and its branches in the Crown Dependencies, Singapore and the USA. For the purposes of our audit of the Bank, we considered the branches to be components of the Bank.

The Group and Bank receive considerable operational support through shared service arrangements with other parts of the Lloyds Banking Group.

Overview

Materiality
- Overall Group materiality: £37,800,000 (2018: £34,000,000), based on 1% of adjusted Tier 1 Capital Resources.
- Overall Bank materiality: £37,800,000 (2018: £34,000,000), based on 1% of adjusted Tier 1 Capital Resources.

Audit scope
- 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 full scope audit procedures over components considered financially significant in the context of the Group and the Bank. These comprised components in the UK, the Crown Dependencies and the USA. Any component which was not already included as a full scope audit 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. We performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to mitigate the risk of material misstatement in the residual components.

Key audit matters
- Determination of expected credit loss allowances (Group and Bank).
- Valuation of complex financial instruments (Group and Bank).
- Privileged access to IT systems (Group and Bank).
- Hedge accounting (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.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and its industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of the rules of the Financial Conduct Authority, Prudential Regulatory Authority, UK tax legislation and equivalent laws and regulations applicable to significant components of the Group and Bank and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered compliance with those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. 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 and Bank 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 and Bank 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 regulation 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 regulatory authorities, including the PRA and the FCA;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the determination of expected credit loss allowances and the valuation of complex financial instruments (see related key audit matters below); and
- Identifying and testing journal entries, in particular any manual journal entries posted by infrequent or unexpected users, posted on unusual days or posted late in the financial reporting process 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
Determination of expected credit loss allowances **Group and Bank** Refer to page 32 (Accounting policies) and page 35 (Critical accounting estimates and judgements). The determination of expected credit loss ("ECL") allowances is subjective. 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. *Use of economic scenarios* Management'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 possible loss distribution which is developed based on historical experience. The scenarios, together with their weightings, are incorporated into the calculation of the allowance for ECL. *ECLs on Stage 1 and 2 positions* An expected credit loss allowance is determined on 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 a statistical model based on key assumptions including significant increase in credit risk criteria (which determines whether a loan is in Stage 1 or 2), probability of default and loss given default. The expected credit loss calculation model is separate to the underlying loan systems, hence the complete and accurate transfer of data into the model is an important step in ensuring the integrity of the calculation of the expected credit loss. *ECLs on Stage 3 positions* Expected credit loss allowances relating to credit impaired loans and advances (referred to as being in Stage 3) are 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 credit loss based on expected future cash flows related to that loan under multiple weighted scenario outcomes.	*Use of economic scenarios* 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 assessed: – 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 management'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. We independently evaluated management's model by assessing the appropriateness of the code and independently applying it. We performed testing to evaluate the level of non-linearity captured in the allowance for ECLs and 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. *ECLs on Stage 1 and 2 positions* We understood management's process and evaluated and tested key controls around the determination of ECL allowances, including controls relating to: – 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 ECLs.

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 ECL models; and
- We critically assessed the impact of identified model limitations and the completeness of overlays applied by management.

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

ECLs on Stage 3 positions
We understood management's process and evaluated and tested key controls around the determination of ECL allowances, including controls relating to:

- 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 ECL allowance.

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

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

- We critically assessed the criteria for determining whether a credit impairment event had occurred; and
- We haphazardly tested a sample of Stage 1 and 2 loans. For each sample, we independently assessed whether they had indicators of 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; and
- Re-performed management's allowance calculation, testing key inputs including expected future cash flows, discount rates, valuations of collateral held and the weightings applied to scenario outcomes.

Based on the evidence obtained, we determined the methodologies, inputs and assumptions to be appropriate.

Valuation of complex financial instruments
Group and Bank
Refer to page 30 (Accounting Policies), page 69 (Note 32–Financial instruments) and page 35 (Critical Accounting Estimates).

The Group and Bank hold a portfolio of fair value assets and liabilities classified as level 3 instruments as their valuations are subjective and determined using bespoke models which rely on a range of unobservable inputs.

We understood and tested the key controls around the valuation processes including the independent price verification and valuation governance controls.

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

With the support of our valuation specialists, we performed the following further testing:

- Tested the completeness of the level 3 population through review and testing of the methodology used by management to identify level 3 products;
- Evaluated the appropriateness of management's valuation methodologies and tested their application;
- Assessed the reasonableness of valuations by independently revaluing a sample of financial assets and liabilities; and
- Evaluated key inputs and assumptions, with reference to matters including historic performance, market information and perspectives, servicer and trustee reports and investment prospectuses.

Based on the evidence obtained, we determined the methodologies, inputs and assumptions to be appropriate.

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. These processes, and associated controls, are largely provided and operated by the Lloyds Banking Group as part of the shared service arrangements.

For the purposes of our audit, we validate the design 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 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, 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 evaluated and 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 work, 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 and tested mitigating controls, and performed additional audit procedures in order to respond to the impact on our overall audit approach.

Hedge accounting
Group and Bank
Refer to page 31 (Accounting Policies) and pages 44 to 46 (Note 13-Derivatives).

The Group and Bank enter into derivative contracts in order to manage and economically hedge risks such as interest rate risk. These arrangements create accounting mismatches which are addressed through designating instruments into fair value or cash flow hedge accounting relationships.

The Group and Bank'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.

Potential impact of Coronavirus **Group and Bank** Refer to page 97 (Note 38-Events since the balance sheet date). There is a global pandemic of Coronavirus which has taken hold in the UK and other territories in which the Group and Bank operate. This has been disruptive to financial markets and normal patterns of human behaviour. This is anticipated to translate into an adverse impact on the global economy. In response, the UK and other governments, and the Bank of England, have announced measures designed to ameliorate resulting adverse impacts on the economy. The directors have specifically considered the impact on the financial statements, including its impact on their going concern assessment and the 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 and development of the outbreak across the world; – The timing and nature, in particular, 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 assessing the directors' going concern assessment , we evaluated whether it considered impacts arising from Coronavirus. Our procedures in this respect included: – Evaluating the appropriateness of the stress scenarios used and their impact on the Group's and Bank's capital, liquidity positions and operating plans; and – Substantiating the Group's and Bank's liquid deposits held at 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 and Bank operate in a number of territories as described in the Context. The Group and Bank receive considerable operational support through shared service arrangements with other parts of the Lloyds Banking Group.

In establishing the overall approach to the Group and Bank audits, we determined the type of work that is required to be performed over the components by us, as the Group and Bank engagement team, or auditors within PwC UK and from other PwC network firms operating under our instruction ('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 has 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, site visits and attendance at 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 audit 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.

All remaining components were subject to procedures which mitigated the risk of material misstatement including testing of entity level controls, information technology general controls and Group, Bank and component level analytical review procedures.

Certain account balances were audited centrally by the Group and Bank engagement team. In addition, we performed testing over certain activities and controls operating in the shared service centres across the Lloyds Banking Group.

Components within the scope of our Group audit contributed 99% of Group total assets and 86% 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	£37,800,000 (2018: £34,000,000).	£37,800,000 (2018: £34,000,000).
How we determined it	1% of adjusted Tier 1 Capital Resources.	1% of adjusted Tier 1 Capital Resources.
Rationale for benchmark applied	Tier 1 Capital Resources is used as a benchmark as it is a primary focus for the users of the financial statements. We have adjusted the benchmark amount to reinstate the foreseeable, but as yet unpaid and undeclared, dividend as it is a technical adjustment, not yet required to be given accounting recognition, and the resources remain in the Group at the year end.	Tier 1 Capital Resources is used as a benchmark as it is a primary focus for the users of the financial statements. We have adjusted the benchmark amount to reinstate the foreseeable, but as yet unpaid and undeclared, dividend as it is a technical adjustment, not yet required to be given accounting recognition, and the resources remain in the Bank at the year end.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £3,000,000 and £34,000,000. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £1,800,000 (Group audit) (2018: £1,700,000) and £1,800,000 (Bank audit) (2018: £1,700,000) 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.

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 in respect of the financial statements, 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 directors on 28 September 2016 to audit the financial statements for the year ended 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement is 3 years, covering the years ended 31 December 2017 to 31 December 2019.

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

25 March 2020

Group consolidated income statement

for the year ended 31 December

	Note	2019 £m	2018[1] £m
Interest and similar income		**813**	354
Interest and similar expense		**(643)**	(251)
Net interest income	4	**170**	103
Fee and commission income		**230**	148
Fee and commission expense		**(42)**	(27)
Net fee and commission income	5	**188**	121
Net trading income	6	**461**	231
Other income		**649**	352
Total income		**819**	455
Operating expenses	7	**(462)**	(273)
Trading surplus		**357**	182
Impairment credit	8	**11**	8
Profit before tax		**368**	190
Tax expense	10	**(85)**	(30)
Profit for the year		**283**	160
Profit attributable to ordinary shareholders		**234**	135
Profit attributable to other equity holders		**49**	25
Profit for the year		**283**	160

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

The Group	2019 £m	2018[1] £m
Profit for the year	**283**	160
Other comprehensive income/(expense)		
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income assets:		
Change in fair value	**(1)**	(11)
Tax	**(1)**	4
	(2)	(7)
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**78**	6
Net income statement transfers	**(7)**	–
Tax	**(20)**	(1)
	51	5
Movements in foreign currency translation (tax: nil)	**(2)**	2
Other comprehensive income for the year, net of tax	**47**	–
Total comprehensive income for the year	**330**	160
Total comprehensive income attributable to ordinary shareholders	**281**	135
Total comprehensive income attributable to other equity holders	**49**	25
Total comprehensive income for the year	**330**	160

The Bank	2019 £m	2018[1] £m
Profit for the year	**397**	113
Other comprehensive income/(expense)		
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income assets:		
Change in fair value	**(1)**	(11)
Tax	**(1)**	4
	(2)	(7)
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**78**	6
Net income statement transfers	**(7)**	–
Tax	**(20)**	(1)
	51	5
Movements in foreign currency translation (tax: nil)	**(1)**	–
Other comprehensive income for the year, net of tax	**48**	(2)
Total comprehensive income/(expense) for the year	**445**	111
Total comprehensive income attributable to ordinary shareholders	**396**	93
Total comprehensive income attributable to other equity holders	**49**	18
Total comprehensive income for the year	**445**	111

1 Restated, see note 1.

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

Balance sheets

at 31 December

	Note	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Assets					
Cash and balances at central banks	11	**16,250**	14,448	**16,250**	14,441
Items in the course of collection from banks		**21**	2	**21**	–
Financial assets at fair value through profit or loss	12	**18,146**	17,171	**18,059**	17,092
Derivative financial instruments	13	**18,836**	15,867	**18,892**	15,921
Loans and advances to banks	14	**4,813**	2,583	**4,792**	2,561
Loans and advances to customers	14	**20,264**	20,684	**19,986**	17,036
Debt securities	14	**112**	132	**112**	132
Due from fellow Lloyds Banking Group undertakings	14	**710**	6,593	**819**	1,388
Financial assets at amortised cost	14	**25,899**	29,992	**25,709**	21,117
Financial assets at fair value through other comprehensive income	17	**314**	412	**314**	412
Property, plant and equipment	18	**72**	15	**55**	6
Current tax recoverable		**2**	–	**–**	–
Deferred tax asset	21	**6**	6	**2**	4
Investment in subsidiary undertakings	19	**–**	–	**295**	908
Other assets	20	**115**	558	**105**	533
Total assets		**79,661**	78,471	**79,702**	70,434

Equity and liabilities	Note	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Liabilities					
Deposits from banks		**3,970**	3,177	**3,970**	3,176
Customer deposits		**24,479**	26,870	**24,010**	14,180
Due to fellow Lloyds Banking Group undertakings		**1,638**	1,794	**2,084**	6,501
Financial liabilities at fair value through profit or loss	22	**13,784**	14,008	**13,784**	14,008
Derivative financial instruments	13	**17,762**	14,511	**17,762**	14,510
Debt securities in issue	23	**12,429**	12,942	**12,429**	12,942
Current tax liability		**30**	23	**24**	19
Deferred tax liability	21	**18**	–	**16**	–
Other liabilities	24	**577**	429	**550**	401
Subordinated liabilities	25	**698**	725	**698**	725
Total liabilities		**75,385**	74,479	**75,327**	66,462
Equity					
Share capital	26	**120**	120	**120**	120
Other reserves	27	**32**	(15)	**31**	(17)
Retained profits[1]	28	**3,342**	3,105	**3,442**	3,087
Shareholders' equity		**3,494**	3,210	**3,593**	3,190
Other equity instruments	29	**782**	782	**782**	782
Total equity		**4,276**	3,992	**4,375**	3,972
Total equity and liabilities		**79,661**	78,471	**79,702**	70,434

1 The Group has elected to take the exemption under section 408 of the Companies Act 2006 not to present the Bank's income statement. The Bank recorded a profit after tax for the year of £397 million (2018: £113 million).

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

The financial statements were approved by the Board of Directors and were signed on its behalf by:

Eduardo J Stock da Cunha
Director

Christopher J K Edis
Director

25 March 2020

Statements of changes in equity

for the year ended 31 December

The Group	Share capital £m	Other reserves £m	Retained earnings £m	Total £m	Other equity instruments £m	Total £m
Balance at 1 January 2019	**120**	**(15)**	**3,105**	**3,210**	**782**	**3,992**
Comprehensive income						
Profit for the year	–	–	**283**	**283**	–	**283**
Other comprehensive income/(expense)						
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax:						
Debt securities	–	**(2)**	–	**(2)**	–	**(2)**
Movements in cash flow hedging reserve, net of tax	–	**51**	–	**51**	–	**51**
Currency translation differences (tax: nil)	–	**(2)**	–	**(2)**	–	**(2)**
Total other comprehensive income	–	**47**	–	**47**	–	**47**
Total comprehensive income	–	**47**	**283**	**330**	–	**330**
Transactions with owners						
Distributions on other equity instruments	–	–	**(49)**	**(49)**	–	**(49)**
Other adjustments	–	–	**3**	**3**	–	**3**
Total transactions with owners	–	–	**(46)**	**(46)**	–	**(46)**
Balance at 31 December 2019	**120**	**32**	**3,342**	**3,494**	**782**	**4,276**

The Group	Share capital £m	Other reserves £m	Retained earnings £m	Total £m	Other equity instruments £m	Total £m
Balance as at 1 January 2018	20	–	–	20	–	20
Comprehensive income						
Profit for the year[1]	–	–	160	160	–	160
Other comprehensive income/(expense)						
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax:						
Debt securities	–	(7)	–	(7)	–	(7)
Movements in cash flow hedging reserve, net of tax	–	5	–	5	–	5
Currency translation differences (tax: nil)	–	2	–	2	–	2
Total other comprehensive result	–	–	–	–	–	–
Total comprehensive income	–	–	160	160	–	160
Transactions with owners						
Distributions on other equity instruments[1]	–	–	(25)	(25)	–	(25)
Issue of ordinary shares	100	–	–	100	–	100
Issue of other equity instruments	–	–	–	–	782	782
Establishment of foreign currency translation opening reserve	–	(15)	15	–	–	–
Opening reserves adjustment in respect of other transfers	–	–	(20)	(20)	–	(20)
Capital contribution received	–	–	2,975	2,975	–	2,975
Total transactions with owners	100	(15)	2,945	3,030	782	3,812
Balance at 31 December 2018	120	(15)	3,105	3,210	782	3,992

1 Restated, see note 1.

Further details of movements in the Group's share capital and reserves are provided in notes 26, 27, 28 and 29.

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

Statements of changes in equity

for the year ended 31 December

The Bank	Share capital £m	Other reserves £m	Retained earnings £m	Total £m	Other equity instruments £m	Total £m
Balance at 1 January 2019	**120**	**(17)**	**3,087**	**3,190**	**782**	**3,972**
Comprehensive income						
Profit for the year	–	–	**397**	**397**	–	**397**
Other comprehensive income/(expense)						
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax:						
Debt securities	–	**(2)**	–	**(2)**	–	**(2)**
Movements in cash flow hedging reserve, net of tax	–	**51**	–	**51**	–	**51**
Currency translation differences (tax: nil)	–	**(1)**	–	**(1)**	–	**(1)**
Total other comprehensive income	–	**48**	–	**48**	–	**48**
Total comprehensive income	–	**48**	**397**	**445**	–	**445**
Transactions with owners						
Distributions on other equity instruments	–	–	**(49)**	**(49)**	–	**(49)**
Other adjustments	–	–	**7**	**7**	–	**7**
Total transactions with owners	–	–	**(42)**	**(42)**	–	**(42)**
Balance at 31 December 2019	**120**	**31**	**3,442**	**3,593**	**782**	**4,375**

The Bank	Share capital £m	Other reserves £m	Retained earnings £m	Total equity m	Other equity instruments £m	Total £m
Balance at 1 January 2018	20	–	–	20	–	20
Comprehensive income						
Profit for the year[1]	–	–	113	113	–	113
Other comprehensive income/(expense)						
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax:						
Debt securities	–	(7)	–	(7)	–	(7)
Movements in cash flow hedging reserve, net of tax	–	5	–	5	–	5
Currency translation differences (tax: nil)	–	–	–	–	–	–
Total other comprehensive expense	–	(2)	–	(2)	–	(2)
Total comprehensive income	–	(2)	113	111	–	111
Transactions with owners						
Distributions on other equity instruments[1]	–	–	(25)	(25)	–	(25)
Issue of ordinary shares	100	–	–	100	–	100
Issue of other equity instruments	–	–	–	–	782	782
Establishment of foreign currency translation opening reserve	–	(15)	15	–	–	–
Opening reserves adjustment in respect of other transfers	–	–	9	9	–	9
Capital contribution received	–	–	2,975	2,975	–	2,975
Total transactions with owners	100	(15)	2,974	3,059	782	3,841
Balance at 31 December 2018	120	(17)	3,087	3,190	782	3,972

1 Restated, see note 1.

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

Cash flow statements

for the year ended 31 December

	Note	The Group		The Bank	
		2019 £m	2018[1] £m	**2019 £m**	2018[1] £m
Profit before tax		**368**	190	**473**	135
Adjustments for:					
Change in operating assets	37a	**2,562**	(10,834)	**(1,150)**	(18,123)
Change in operating liabilities	37b	**836**	34,635	**(2,329)**	41,916
Non-cash and other items	37c	**18**	9	**(158)**	17
Tax paid		**(81)**	–	**(72)**	
Net cash generated from/(used in) operating activities		**3,703**	24,000	**(3,236)**	23,945
Cash flows from investing activities					
Purchase of fixed assets		**(5)**	(47)	**(1)**	(8)
Proceeds from sale and maturity of fixed assets		**–**	4	**–**	–
Dividends received from subsidiary undertakings		**–**	–	**811**	–
Acquisition of businesses		**–**	(13,042)	**6,130**	(13,049)
Net cash (used in)/generated from investing activities		**(5)**	(13,085)	**6,940**	(13,057)
Cash flows generated from financing activities					
Distributions on other equity instruments		**(49)**	(25)	**(49)**	(25)
Interest paid on subordinated liabilities		**(32)**	(15)	**(32)**	(15)
Receipt of capital contribution from parent company		**–**	2,975	**-**	2,975
Issue of subordinated liabilities		**–**	725	**–**	725
Issue of other equity instruments		**–**	782	**–**	782
Issue of ordinary share capital		**–**	100	**–**	100
Net cash (used in)/generated from financing activities		**(81)**	4,542	**(81)**	4,542
Effect of exchange rate changes on cash and cash equivalents		**(1)**	1	**–**	–
Change in cash and cash equivalents		**3,616**	15,458	**3,623**	15,430
Cash and cash equivalents at beginning of year		**15,478**	20	**15,450**	20
Cash and cash equivalents at end of year	37d	**19,094**	15,478	**19,073**	15,450

1 Restated, see note 1.

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

1 Basis of preparation

The financial statements of Lloyds Bank Corporate Markets 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 (Lloyds Bank Corporate Markets plc and its subsidiaries) 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 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 from page 16) 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 7 and additionally have considered projections for the Group's capital and funding position. The Bank relies on its holding company for issuance of equity and subordinated debt. 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 has 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 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 the 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 39.

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 the distributions on other equity instruments, previously taken directly to retained profits, is now reported in 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 Group and Bank profit for the year 2019 of £13 million (2018: £7 million). There was no impact on shareholders' equity.

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 35.

Details of those IFRS pronouncements which will be relevant to the Group but were not effective at 31 December 2019 and which have not been applied in preparing these financial statements are given in note 40.

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. Details of the Bank's subsidiaries are given in note 42.

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 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.

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

Predecessor accounting has been applied to the business transfers as described in note 3. 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 or share capital (see note 2l). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

b 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 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 note 2f 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 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 c(3) below; those relating to leases are set out in h(2) below.

c 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. 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, 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.

2 Accounting policies (continued)

(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. Interest income is accounted for using the effective interest method (see note 2b 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. 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. 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. In addition, the Group recognises a charge for expected credit losses in the income statement (see note 2f 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 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 as they are managed on a fair value basis and accordingly 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.

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.

(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 assets. 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.

d 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 in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 32(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

2 Accounting policies (continued)

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, or forecast to be highly effective, in achieving its documented objective, hedge accounting is discontinued. Note 13 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 identified and 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.

e 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.

f Impairment of financial assets
The impairment credit 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 by 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 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, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime 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 are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3. Predecessor accounting has been applied to the business transfers as described in note 3 and impairment allowances for financial assets were brought in to the financial statements at the predecessor carrying values.

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 historic delinquency. 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.

2 Accounting policies (continued)

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 in default (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 and are recognised when received. 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 concessions 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.

g 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.

h 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 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 lease 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.

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 assets is depreciated over the shorter of the asset's useful life and 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 or loss. Short-term leases are leases with a lease term of twelve months or less. Low-value assets comprise IT equipment and small items of office furniture.

i 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.

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.

2 Accounting policies (continued)

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.

j Foreign currency translation
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The principal functional currency of the Group and the Bank is sterling. 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 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 note 2d(3) above). 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.

k 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 note 2f above).

l 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.

m 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.

n Investment in subsidiaries of the bank
Investments in subsidiaries are carried at historical cost, less any provisions for impairment.

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3 Critical accounting estimates and judgements

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

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

Business transfers and use of predecessor accounting
A business is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities. It was judged that the assets, liabilities and subsidiaries which transferred during the current and prior years meet this definition and therefore constitutes the transfer of a business.

IFRS does not prescribe the specific treatment for business combinations in these circumstances. The Group's accounting policy for such transfers of business is to apply predecessor accounting. This means that the transferred assets and liabilities were not restated to their fair values in the consolidated accounts of LBCM and no goodwill was recognised. Instead, they were brought into the LBCM financial statements at the predecessor carrying values which, for loans, include any existing impairment provisions, the origination PDs and staging. The Group and Bank also recognise any amounts that the transferor had previously accumulated on transferred assets and liabilities in relation to fair value through other comprehensive income and foreign currency translation reserves. Predecessor accounting is only adopted on a prospective basis. LBCM paid consideration equivalent to predecessor carrying value.

3 Critical accounting estimates and judgements (continued)

Fair value of financial instruments
At 31 December 2019, the carrying value of the Group's financial instrument assets held at fair value was £37,296 million (2018: £33,450 million), and its financial instrument liabilities held at fair value was £31,546 million (2018: £28,519 million). Included within these balances are derivative assets of £18,836 million (2018: £15,867 million) and derivative liabilities of £17,762 million (2018: £14,511 million). The Group's accounting policy for its financial instruments is set out in notes 2c and 2d.

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 judgements and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. For example, a judgement is made that the position is level 1, 2 or 3 or in selecting a valuation methodology. An example of an estimate would be quantitative inputs to level 3.

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 32. 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 32.

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 credit loss allowance was £91 million (2018: £105 million), of which £87 million (2018: £102 million) was in respect of drawn balances; and the Bank's expected credit loss allowance was £90 million (2018: £91 million), of which £86 million (2018: £88 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(f) Impairment of financial assets.

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 take 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 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. In our Retail business, both quantitative measures (arrears counters) and qualitative measures (individual assessment) are used to determine whether a SICR event has happened. 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 may be identified through its on-going assessment of the models. In these circumstances, management judgement is used to make appropriate adjustments to the Group's allowance for impairment losses. These adjustments are generally modelled taking into account the particular attributes of the exposure which have not been adequately captured by the primary impairment models. At 31 December 2019, post-model adjustments included within the Group's allowance for expected credit losses amounted to £nil (2018: £nil).

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 five years beyond 2019 are mapped to industry-wide historical loss data by portfolio. 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.

3 Critical accounting estimates and judgements (continued)

To allow for this a relatively unlikely severe downside scenario is therefore included. At 1 January and 31 December 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 LBG Chief Economist meets quarterly, to review and, if appropriate, recommend changes to the economic scenarios to the LBCM Chief Financial Officer and LBCM Chief Risk Officer. Findings dealing with all aspects of the expected credit loss calculation are presented to the LBCM 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			
UK economic assumptions	**Base case %**	**Upside %**	**Downside %**	**Severe downside %**	Base case %	Upside %	Downside %	Severe downside %
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 economic uncertainty, 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			
UK economic assumptions – start to peak	**Base case %**	**Upside %**	**Downside %**	**Severe downside %**	Base case %	Upside %	Downside %	Severe downside %
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			
UK economic assumptions – start to trough	**Base case %**	**Upside %**	**Downside %**	**Severe downside %**	Base case %	Upside %	Downside %	Severe downside %
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 extent to which a higher ECL allowance has been recognised to take account of forward looking information from the weighted multiple economic scenarios and the Group's ECL for the upside, downside and severe downside scenarios using a 100 per cent weighting compared to the base case scenario.

Impact of multiple economic scenarios	**Probability Weighting £m**	**Base case £m**	**Upside £m**	**Downside £m**	**Severe downside £m**
At 31 December 2019	**91**	**90**	**87**	**94**	**101**
At 31 December 2018	105	104	102	103	111

4 Net interest income

	2019 £m	2018 £m
Interest and similar income:		
Loans and advances to customers	**567**	246
Loans and advances to banks	**239**	106
Debt securities held at amortised cost	**1**	–
Interest receivable on financial assets held at amortised cost	**807**	352
Financial assets at fair value through other comprehensive income	**6**	2
Total interest and similar income[1]	**813**	354
Interest and similar expense:		
Deposits from banks	**(10)**	(4)
Customer deposits	**(343)**	(207)
Debt securities in issue	**(259)**	(20)
Subordinated liabilities	**(31)**	(20)
Total interest and similar expense[2]	**(643)**	(251)
Net interest income	**170**	103

1 Includes £nil (2018: £nil) of interest income on liabilities with negative interest rates and £6 million (2018: £nil) in respect of interest income on finance leases.

2 Includes £nil (2018: £nil) of interest expense on assets with negative interest rates and £3 million (2018: £nil) in respect of interest expense on lease liabilities.

Included within interest income is £2 million (2018: £nil) in respect of credit impaired financial assets. Net interest income also includes a credit of £9 million (2018: £nil) transferred from the cash flow hedging reserve (see note 27).

5 Net fee and commission income

	2019 £m	2018 £m
Fee and commission income:		
Commercial banking and treasury fees	**213**	137
Current accounts	**5**	3
Private banking and asset management	**4**	2
Credit and debit card fees	**3**	2
Other fees and commissions	**5**	4
Total fee and commission income	**230**	148
Fee and commission expense	**(42)**	(27)
Net fee and commission income	**188**	121

Fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 4. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 6.

At 31 December 2019, the Group held on its balance sheet £4 million (31 December 2018: £7 million) in respect of services provided to customers and £nil (31 December 2018: £nil) in respect of amounts received from customers for services to be provided after the balance sheet date. Current unsatisfied performance obligations amount to £nil (31 December 2018: £nil); the Group expects to receive substantially all of this revenue by 2022.

Income recognised during the year ended 31 December 2019 included £nil in respect of amounts included in the contract liability balance at 31 December 2018 and £nil in respect of amounts from performance obligations satisfied in previous years.

The most significant performance obligations undertaken by the Group are in respect of current accounts, the provision of other banking services for commercial customers, credit and debit card services and investment management services.

6 Net trading income

	2019 £m	2018 £m
Foreign exchange translation (losses)/gains	(12)	53
Gains on foreign exchange trading transactions	82	345
Total foreign exchange	70	398
Securities and other gains/(losses) (see below)	391	(167)
Net trading income	461	231

Securities and other gains/(losses) comprise net gains arising on assets and liabilities held at fair value through profit or loss and for trading 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	356	(176)
Other financial instruments mandatorily held at fair value through profit or loss:		
Debt securities, loans and advances	35	3
Net income arising on liabilities held at fair value through profit or loss – debt securities in issue	–	6
Securities and other gains/(losses)	391	(167)

7 Operating expenses

	2019 £m	2018 £m
Staff costs:		
Salaries	138	61
Social security costs	11	5
Pensions and other post-retirement benefit schemes	12	6
Restructuring costs	4	2
Other staff costs	11	4
	176	78
Management charges payable	205	180
Depreciation and amortisation	19	2
Premises and equipment	9	9
Communications and data processing	12	2
Professional fees	8	2
Start up costs for Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH	14	–
Other operating expenses	19	–
Total other operating expense	462	273

Services are received by the Group from other parts of the Lloyds Banking Group via a shared service provision model. This is governed via Intra Group Agreement (IGA) contracts and includes the provision of services supporting the business, operations and support functions. Management charges payable were paid to Lloyds Bank plc in respect of these services. UK-based colleagues are employed through other Lloyds Banking Group companies and costs recharged via the IGA. The terms of the contract are negotiated and renewable to ensure market rate expense for services provided.

The Group had an average of 1,196 (2018: 624) employees during the year based in Singapore, USA, Germany and the Crown Dependencies. 2018 average employees represents a partial year, with a 2018 year end closing position of 1,236 employees.

7 Operating expenses (continued)

Fees payable to the Bank's auditors

	2019 £m	2018 £m
Fees payable for the audit of the Bank's current year annual report	**2.2**	1.8
Audit of the Bank's subsidiaries pursuant to legislation	**0.5**	0.7
Other services provided pursuant to legislation	**0.2**	0.1
Other services – audit related fees	**0.2**	0.3
Total fees payable to the Bank's auditors	**3.1**	2.9

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.

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 listing rules.

8 Impairment credit

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2019				
Changes in credit quality	**1**	**1**	**1**	**3**
(Charges)/releases	**(1)**	**(1)**	**10**	**8**
Methodology, model and assumption changes	**–**	**–**	**–**	**–**
Total impairment	**–**	**–**	**11**	**11**
In respect of:				
Financial assets at amortised cost				
Loans and advances to customers	**1**	**–**	**11**	**12**
Loan commitments and financial guarantees	**(1)**	**–**	**–**	**(1)**
Total impairment	**–**	**–**	**11**	**11**

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Year ended 31 December 2018				
Other changes in credit quality	(2)	–	3	1
(Charges)/releases	1	(2)	8	7
Total impairment	(1)	(2)	11	8
In respect of:				
Financial assets at amortised cost				
Loans and advances to customers	–	(2)	11	9
Loan commitments and financial guarantees	(1)	–	–	(1)
Total impairment	(1)	(2)	11	8

The Group's impairment credit comprises the following items:

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.

(Charges)/Releases
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.

Methodology changes
Increase or decrease in impairment charge as a result of adjustments to the models used for expected credit loss calculations; as either changes to the model inputs (risk parameters) or to the underlying assumptions.

8 Impairment credit (continued)

Model changes
The impact on the impairment charge of changing the models used to calculate expected credit losses.

Movements in the Group's impairment allowances are shown in note 16.

9 Directors' emoluments

The directors' emoluments payable for services provided to the Bank are set out below:

	2019 £000s	2018 £000s
Executive directors	**1,684**	1,468
Non-executive directors	**804**	690
	2,488	2,158

Highest paid director:	**1,095**	1,171

10 Tax expense

a Analysis of tax expense for the year

	2019 £m	2018[1] £m
UK corporation tax:		
– Current tax on profit for the year	**73**	19
– Adjustments in respect of prior years	**(3)**	(2)
Current tax expense	**70**	17
Foreign tax:		
– Current tax on profit for the year	**16**	11
– Adjustments in respect of prior years	**–**	–
Current tax expense	**86**	28
Deferred tax:		
– Current year	**(2)**	–
– Adjustments in respect of prior years	**1**	2
Deferred tax (credit)/expense (see note 21)	**(1)**	2
Tax expense	**85**	30

UK corporation tax is calculated at a rate of 19 per cent (2018: 19 per cent) of the taxable profit for the year.

b Factors affecting the tax expense for the year
An explanation of the relationship between tax expense and accounting profit is set out below:

	2019 £m	2018[1] £m
Profit before tax	**368**	190
UK corporation tax thereon	**(70)**	(36)
Factors affecting (charge)/credit:		
– Impact of surcharge on banking profits	**(23)**	(6)
– Non-deductible costs	**(6)**	(7)
– Tax relief on coupons on other equity instruments	**9**	5
– Non-taxable income and other deductions	**–**	12
– Losses on which deferred tax not recognised	**–**	(2)
– Derecognition of losses that arose in previous years	**–**	(2)
– Differences in overseas tax rates	**3**	6
Adjustments in respect of prior years	**2**	–
Tax expense on profit on ordinary activities	**(85)**	(30)
Effective rate	**23.1%**	15.8%

1 Restated, see note 1.

11 Cash and balances at central banks

Cash and cash equivalents for the purposes of the cash flow statement include the following:

The Group	2019 £m	2018 £m
Cash balances at central banks	**16,241**	14,441
On demand deposits	**9**	7
	16,250	14,448

The Bank	2019 £m	2018 £m
Cash balances at central banks	**16,241**	14,441
On demand deposits	**9**	–
	16,250	14,441

12 Financial assets at fair value through profit or loss

	The Group		The Bank	
	2019 £m	2018 £m	2019 £m	2018 £m
Trading assets	**17,732**	17,089	**17,732**	17,089
Other financial assets at fair value through profit or loss	**414**	82	**327**	3
Total	**18,146**	17,171	**18,059**	17,092

These assets are comprised as follows:

	The Group				The Bank			
	2019		2018		2019		2018	
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to customers	**10,422**	**326**	11,295	3	**10,422**	**326**	11,295	3
Loans and advances to banks	**513**	**–**	612	–	**513**	**–**	612	–
Debt securities:								
Government securities	**6,501**	**–**	4,898	59	**6,501**	**–**	4,898	–
Bank and building society certificates of deposit	**–**	**68**	–	–	**–**	**–**	–	–
Asset-backed securities:								
Mortgage-backed securities	**6**	**–**	10	–	**6**	**–**	10	–
Other asset-backed securities	**17**	**–**	43	–	**17**	**–**	43	–
Corporate and other debt securities	**273**	**1**	231	–	**273**	**1**	231	–
	6,797	**69**	5,182	59	**6,797**	**1**	5,182	–
Treasury bills and other bills	**–**	**19**	–	20	**–**	**–**	–	–
Total	**17,732**	**414**	17,089	82	**17,732**	**327**	17,089	3

At 31 December 2019 £6,885 million (2018: £4,773 million) of trading and other financial assets at fair value through profit or loss of the Group and £6,885 million (2018: £4,791 million) of the Bank had a contractual residual maturity of greater than one year.

For amounts included above which are subject to reverse repurchase agreements see note 32.

During the year the Group and Bank acquired financial assets at fair value through profit or loss of £633 million (2018: £75 million).

13 Derivative financial instruments

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	**41,339**	**533**	**654**	29,359	907	731
Currency swaps	**360,821**	**3,887**	**3,776**	227,530	2,979	3,096
Options purchased	**8,311**	**452**	**–**	9,056	485	–
Options written	**9,558**	**–**	**499**	9,947	–	496
	420,029	**4,872**	**4,929**	275,892	4,371	4,323
Interest rate contracts:						
Interest rate swaps	**3,500,882**	**11,678**	**10,406**	2,554,455	9,419	7,970
Forward rate agreements	**529,314**	**9**	**13**	412,453	4	4
Options purchased	**26,568**	**2,071**	**–**	27,903	1,802	–
Options written	**23,701**	**–**	**2,150**	21,853	–	1,883
Futures	**198,205**	**5**	**18**	126,805	4	–
	4,278,670	**13,763**	**12,587**	3,143,469	11,229	9,857
Credit derivatives	**11,674**	**9**	**71**	10,383	81	153
Equity and other contracts	**4,731**	**177**	**169**	2,370	186	178
Total derivative assets/liabilities held for trading	**4,715,104**	**18,821**	**17,756**	3,432,114	15,867	14,511
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**4,126**	**2**	**–**	5,366	–	–
Derivatives designated as cash flow hedges:						
Interest rate swaps	**10,844**	**13**	**6**	1,998	–	–
Total derivative assets/liabilities held for hedging	**14,970**	**15**	**6**	7,364	–	–
Total recognised derivative assets/liabilities	**4,730,074**	**18,836**	**17,762**	3,439,478	15,867	14,511

13 Derivative financial instruments (continued)

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	**41,339**	**533**	**654**	29,359	907	732
Currency swaps	**360,821**	**3,887**	**3,776**	227,530	2,980	3,096
Options purchased	**8,311**	**452**	**–**	9,056	485	–
Options written	**9,558**	**–**	**499**	9,947	–	496
	420,029	**4,872**	**4,929**	275,892	4,372	4,324
Interest rate contracts:						
Interest rate swaps	**3,500,997**	**11,734**	**10,406**	2,554,451	9,475	7,968
Forward rate agreements	**529,314**	**9**	**13**	412,453	4	4
Options purchased	**26,568**	**2,071**	**–**	27,903	1,802	–
Options written	**23,701**	**–**	**2,150**	21,853	–	1,883
Futures	**198,205**	**5**	**18**	126,805	4	–
	4,278,785	**13,819**	**12,587**	3,143,465	11,285	9,855
Credit derivatives	**11,674**	**9**	**71**	10,383	81	153
Equity and other contracts	**4,731**	**177**	**169**	2,370	183	178
Total derivative assets/liabilities held for trading	**4,715,219**	**18,877**	**17,756**	3,432,110	15,921	14,510
Hedging						
Derivatives designated as fair value hedges:						
Interest rate swaps	**4,126**	**2**	**–**	5,366	–	–
Derivatives designated as cash flow hedges:						
Interest rate swaps	**10,844**	**13**	**6**	1,998	–	–
Total derivative assets/liabilities held for hedging	**14,970**	**15**	**6**	7,364	–	–
Total recognised derivative assets/liabilities	**4,730,189**	**18,892**	**17,762**	3,439,474	15,921	14,510

13 Derivative financial instruments (continued)

At 31 December 2019 £13,874 million of total recognised derivative assets of the Group and the Bank and £12,139 million of total recognised derivative liabilities of the Group and the Bank (2018: £13,360 million of assets and £11,000 million of liabilities) had a contractual residual maturity of greater than one year.

During the year the Group acquired derivative assets of £nil (2018: £23,065 million), with Bank acquiring £nil (2018: £22,984 million) and the Group and Bank acquired derivative liabilities of £nil (2018: £23,327 million).

The amounts for the derivative assets and liabilities in the above tables include the amounts offset in note 34.

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.

The notional amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default.

To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in note 35 Credit risk.

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

	Maturity					
The Group and the Bank – 31 December 2019	**Less than 1 month £m**	**1-3 months £m**	**3 months - 1 year £m**	**1-5 years £m**	**More than 5 years £m**	**Total £m**
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	**–**	**–**	**–**	**2,958**	**1,168**	**4,126**
Average fixed interest rate	**–**	**–**	**–**	**0.27%**	**2.66%**	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	**280**	**165**	**2,187**	**3,530**	**4,682**	**10,844**
Average fixed interest rate	**0.81%**	**0.91%**	**0.18%**	**1.03%**	**1.11%**	

	Maturity					
The Group and the Bank – 31 December 2018	Less than 1 month £m	1-3 months £m	3 months - 1 year £m	1-5 years £m	More than 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	–	–	4,153	1,213	5,366
Average fixed interest rate	–	–	–	1.15%	2.65%	
Cash flow hedges						
Interest rate						
Interest rate swap						
Notional	–	–	170	978	850	1,998
Average fixed interest rate	–	–	0.01%	1.16%	1.38%	

13 Derivative financial instruments (continued)

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

The Group and the Bank – 31 December 2019	Contract/notional amount £m	Carrying amount Assets £m	Carrying amount Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness (YTD) £m
Fair value hedges				
Interest rate				
Interest rate swaps	**4,126**	**2**	**–**	**143**
Cash flow hedges				
Interest rate				
Interest rate swaps	**10,844**	**13**	**6**	**73**

The Group and the Bank – 31 December 2018	Contract/notional amount £m	Carrying amount Assets £m	Carrying amount Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness (YTD) £m
Fair value hedges				
Interest rate				
Interest rate swaps	5,366	–	–	50
Cash flow hedges				
Interest rate				
Interest rate swaps	1,998	–	–	6

All amounts are held within derivative financial instruments.

The Group's hedged items are as follows:

The Group and 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) £m	Cash flow hedge/currency translation reserve	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m		Continuing hedges £m	Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**–**	**4,193**	**–**	**101**	**(147)**		
Cash flow hedges							
Interest rate							
Customer loans[2]					**(22)**	**29**	**–**
Central bank balances[3]					**(46)**	**46**	**–**

The Group and 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) £m	Cash flow hedge/currency translation reserve	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m		Continuing hedges £m	Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	–	5,448	–	45	(45)		
Cash flow hedges							
Interest rate							
Customer loans[2]					(6)	6	–

1 Included within debt securities in issue.

2 Included within loans and advances to customers.

3 Included within cash and balances at central banks.

13 Derivative financial instruments (continued)

The accumulated amount of fair value hedge adjustments remaining in the statement of financial position for hedged items that have ceased to be adjusted for hedging gains and losses is £nil.

The cash flow hedge reserve in the above table is calculated on a pre-deferred tax basis.

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 £nil (2018: £nil).

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

			Amounts reclassified from reserves to income statement as:	
The Group and the Bank – 31 December 2019	**Gain (loss) recognised in other comprehensive income £m**	**Hedge ineffectiveness recognised in the income statement[1] £m**	**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	**23**	**–**	**(3)**	**Interest income**
Central bank balances	**46**	**4**	**(6)**	**Interest income**

			Amounts reclassified from reserves to income statement as:	
The Group and the Bank – 31 December 2018	Gain (loss) recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Hedged item affected income statement £m	Income statement line item that includes reclassified amount
Fair value hedges				
Interest rate				
Fixed rate issuance		5		
Cash flow hedges				
Interest rate				
Customer loans	6		–	Interest income

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.

14 Financial assets at amortised cost

1) The Group

Year ended 31 December 2019 **Loans and advances to customers**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 1 January 2019	20,459	23	303	20,785
Exchange and other adjustments	(154)	–	(1)	(155)
Advances/(repayments)	(245)	(22)	(12)	(279)
Transfers between stages	(32)	28	4	–
Financial assets that have been written off during the year	–	–	(1)	(1)
At 31 December 2019	20,028	29	293	20,350
Allowance for impairment losses	(7)	(2)	(77)	(86)
Total loans and advances to customers	20,021	27	216	20,264

Loans and advances to banks	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 1 January 2019	2,584	–	–	2,584
Exchange and other adjustments	(95)	–	–	(95)
Advances	2,325	–	–	2,325
At 31 December 2019	4,814	–	–	4,814
Allowance for impairment losses	(1)	–	–	(1)
Total loans and advances to banks	4,813	–	–	4,813

Debt securities	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 1 January 2019	132	–	–	132
Exchange and other adjustments	(4)	–	–	(4)
Net decrease in debt securities	(16)	–	–	(16)
At 31 December 2019	112	–	–	112
Allowance for impairment losses	–	–	–	–
Total debt securities	112	–	–	112
Due from fellow Lloyds Banking Group undertakings	710	–	–	710
Total financial assets at amortised cost	25,656	27	216	25,899

14 Financial assets at amortised cost (continued)

Year ended 31 December 2018 Loans and advances to customers	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Balance at 1 January 2018	–	–	–	–
Acquisitions	13,389	29	319	13,737
Advances/(repayments)	7,074	(10)	(17)	7,047
Transfers between stages	(4)	4	–	–
Recoveries	–	–	1	1
At 31 December 2018	20,459	23	303	20,785
Allowance for impairment losses	(7)	(2)	(92)	(101)
Total loans and advances to customers	20,452	21	211	20,684

Loans and advances to banks	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Balance at 1 January 2018	–	–	–	–
Acquisitions	1,970	8	–	1,978
Advances/(repayments)	614	(8)	–	606
At 31 December 2018	2,584	–	–	2,584
Allowance for impairment losses	(1)	–	–	(1)
Total loans and advances to banks	2,583	–	–	2,583

Debt securities	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Balance at 1 January 2018	–	–	–	–
Acquisitions	160	–	–	160
Net increase (decrease) in debt securities	(28)	–	–	(28)
At 31 December 2018	132	–	–	132
Allowance for impairment losses	–	–	–	–
Total debt securities	132	–	–	132
Due from fellow Lloyds Banking Group undertakings	6,593	–	–	6,593
Total financial assets at amortised cost	29,760	21	211	29,992

Transfers of assets between stages are deemed to take place at the start of the year. All other movements in the value of the asset are deemed to take place within the stage under which that asset is reported at the end of the year.

14 Financial assets at amortised cost (continued)

2) The Bank

Year ended 31 December 2019 **Loans and advances to customers**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 1 January 2019	16,849	–	277	17,126
Exchange and other adjustments	(153)	–	–	(153)
Acquisitions	2,975	5	17	2,997
Advances/(repayments)	118	(17)	–	101
Transfer between stages	(30)	31	(1)	–
At 31 December 2019	19,759	19	293	20,071
Allowance for impairment losses	(6)	(2)	(77)	(85)
Total loans and advances to customers	19,753	17	216	19,986

Loans and advances to banks	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 1 January 2019	2,562	–	–	2,562
Exchange and other adjustments	(94)	–	–	(94)
Acquisitions	8	–	–	8
Advances	2,317	–	–	2,317
At 31 December 2019	4,793	–	–	4,793
Allowance for impairment losses	(1)	–	–	(1)
Total loans and advances to banks	4,792	–	–	4,792

Debt securities	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 1 January 2019	132	–	–	132
Exchange and other adjustments	(4)	–	–	(4)
Net decrease in debt securities	(16)	–	–	(16)
At 31 December 2019	112	–	–	112
Allowance for impairment losses	–	–	–	–
Total debt securities	112	–	–	112
Due from fellow Lloyds Banking Group undertakings	819	–	–	819
Total financial assets at amortised cost	25,476	17	216	25,709

14 Financial assets at amortised cost (continued)

2) The Bank

Year ended 31 December 2018 Loans and advances to customers	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Balance at 1 January 2018	–	–	–	–
Acquisitions	11,521	–	277	11,798
Advances/(repayments)	5,328	–	–	5,328
At 31 December 2018	16,849	–	277	17,126
Allowance for impairment losses	(8)	–	(82)	(90)
Total loans and advances to customers	16,841	–	195	17,036

Loans and advances to banks	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Balance at 1 January 2018	–	–	–	–
Acquisitions	1,911	–	–	1,911
Advances/(repayments)	651	–	–	651
At 31 December 2018	2,562	–	–	2,562
Allowance for impairment losses	(1)	–	–	(1)
Total loans and advances to banks	2,561	–	–	2,561

Debt securities	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Balance at 1 January 2018	–	–	–	–
Acquisitions	160	–	–	160
Net increase (decrease) in debt securities	(28)	–	–	(28)
At 31 December 2018	132	–	–	132
Allowance for impairment losses	–	–	–	–
Total debt securities	132	–	–	132
Due from fellow Lloyds Banking Group undertakings	1,388	–	–	1,388
Total financial assets at amortised cost	20,922	–	195	21,117

Transfers of assets between stages are deemed to take place at the start of the year. All other movements in the value of the asset are deemed to take place within the Stage under which that asset is reported at the end of the year.

Advances (repayments) comprise new loans originated and repayments of outstanding balances throughout the reporting year. 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 £9,465 million of loans and advances to customers of the Group and £9,233 million of the Bank had a contractual residual maturity of greater than one year (2018: £7,846 million of the Group and £5,772 million of the Bank).

15 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 follow:

	The Group	
	2019 £m	2018 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**6**	6
Later than 1 year and not later than 2 years	**7**	6
Later than 2 years and not later than 3 years	**7**	7
Later than 3 years and not later than 4 years	**7**	7
Later than 4 years and not later than 5 years	**7**	7
Later than 5 years	**188**	196
	222	229
Unearned future finance income on finance leases	**(85)**	(91)
Rentals received in advance	**(2)**	(2)
Net investment in finance leases	**135**	136

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

	The Group	
	2019 £m	2018 £m
Not later than 1 year	**(1)**	(3)
Later than 1 year and not later than 2 years	**–**	–
Later than 2 years and not later than 3 years	**1**	1
Later than 3 years and not later than 4 years	**1**	1
Later than 4 years and not later than 5 years	**1**	1
Later than 5 years	**133**	136
Net investment in finance leases	**135**	136

Equipment leased to customers under finance leases primarily relates to structured financing transactions in connection with infrastructure assets. There was no allowance for uncollectable finance lease receivables included in the allowance for impairment losses.

16 Allowance for impairment losses

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

The Group Year ended 31 December 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2019	8	2	92	102
Exchange and other adjustments	1	–	(3)	(2)
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
	–	–	–	–
Items charged/(credited) to the Income Statement (note 8)	(1)	–	(11)	(12)
Total charge/(credit)	(1)	–	(11)	(12)
Advances written off	–	–	(1)	(1)
Recoveries of advances written off in previous years	–	–	1	1
Discount unwind	–	–	(1)	(1)
At 31 December 2019	8	2	77	87
In respect of undrawn balances				
Balance at 1 January 2019	3	–	–	3
Exchange and other adjustments	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
	–	–	–	–
Items charged to the Income Statement (note 8)	1	–	–	1
Total charge	1	–	–	1
At 31 December 2019	4	–	–	4
Total	12	2	77	91
In respect of:				
Loans and advances to banks	1	–	–	1
Loans and advances to customers	7	2	77	86
Debt securities	–	–	–	–
Financial assets at amortised cost	8	2	77	87
Other assets	–	–	–	–
Provisions in relation to loan commitments and financial guarantees	4	–	–	4
Total	12	2	77	91

16 Allowance for impairment losses (continued)

The Group **Year ended 31 December 2018**	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2018	–	–	–	–
Acquisitions	8	–	107	115
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
Items charged/(credited) to the Income Statement	–	2	(11)	(9)
Total charge/(credit)	–	2	(11)	(9)
Recoveries of advances written off in previous years	–	–	1	1
Discount unwind	–	–	(5)	(5)
At 31 December 2018	8	2	92	102
In respect of undrawn balances				
Balance at 1 January 2018	–	–	–	–
Acquisitions	2	–	–	2
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
Items charged to the Income Statement	1	–	–	1
Total charge	1	–	–	1
At 31 December 2018	3	–	–	3
Total	11	2	92	105
In respect of:				
Loans and advances to banks	1	–	–	1
Loans and advances to customers:	7	2	92	101
Debt securities	–	–	–	–
Financial assets at amortised cost	8	2	92	102
Other assets	–	–	–	–
Provisions in relation to loan commitments and financial guarantees	3	–	–	3
Total	11	2	92	105

16 Allowance for impairment losses (continued)

The Bank Year ended 31 December 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2019	6	–	82	88
Exchange and other adjustments	–	–	(2)	(2)
Acquisitions	1	–	7	8
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
	–	–	–	–
Items charged/(credited) to the Income Statement	–	2	(9)	(7)
Total charge	–	2	(9)	(7)
Recoveries of advances written off in previous years	–	–	–	–
Discount unwind	–	–	(1)	(1)
At 31 December 2019	7	2	77	86
In respect of undrawn balances				
Balance at 1 January 2019	3	–	–	3
Exchange and other adjustments	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
	–	–	–	–
Items charged to the Income Statement	1	–	–	1
Total charge	1	–	–	1
At 31 December 2019	4	–	–	4
Total	11	2	77	90
In respect of:				
Loans and advances to banks	1	–	–	1
Loans and advances to customers:	6	2	77	85
Debt securities	–	–	–	–
Financial assets at amortised cost	7	2	77	86
Other assets	–	–	–	–
Provisions in relation to loan commitments and financial guarantees	4	–	–	4
Total	11	2	77	90

16 Allowance for impairment losses (continued)

The Bank **Year ended 31 December 2018**	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of drawn balances				
Balance at 1 January 2018	–	–	–	–
Acquisitions	5	–	89	94
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
Items charged/(credited) to the Income Statement	1	–	(2)	(1)
Total charge	1	–	(2)	(1)
Recoveries of advances written off in previous years	–	–	–	–
Discount unwind	–	–	(5)	(5)
At 31 December 2018	6	–	82	88
In respect of undrawn balances				
Balance at 1 January 2018	–	–	–	–
Acquisitions	3	–	–	3
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact of transfers between stages	–	–	–	–
Items charged to the Income Statement	–	–	–	–
Total charge	–	–	–	–
At 31 December 2018	3	–	–	3
Total	9	–	82	91
In respect of:				
Loans and advances to banks	1	–	–	1
Loans and advances to customers:	8	–	82	90
Debt securities	–	–	–	–
Financial assets at amortised cost	9	–	82	91
Other assets	–	–	–	–
Provisions in relation to loan commitments and financial guarantees	–	–	–	–
Total	**9**	–	**82**	**91**

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 2018 and 2019.

Net increase and decrease in balances comprise 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.

17 Financial assets at fair value through other comprehensive income

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Debt securities:				
Government securities	**–**	–	**–**	–
Bank and building society certificates of deposit	**97**	136	**97**	136
Asset-backed securities:				
Mortgage-backed securities	**–**	–	**–**	–
Other asset-backed securities	**121**	121	**121**	121
Corporate and other debt securities	**–**	73	**–**	73
	218	330	**218**	330
Treasury and other bills	**96**	82	**96**	82
Total financial assets at fair value through other comprehensive income	**314**	412	**314**	412

At 31 December 2019 £121 million (2018: £195 million) of financial assets at fair value through other comprehensive income of the Group and the Bank had a contractual residual maturity of greater than one year.

All assets have been assessed as Stage 1 at initial recognition at 31 December 2018 and 2019.

18 Property, plant and equipment

	The Group					The Bank				
	Premises £m	**Equipment £m**	**Operating lease assets £m**	**Right-of-use asset[1] £m**	**Total £m**	**Premises £m**	**Equipment £m**	**Operating lease assets £m**	**Right-of-use asset[1] £m**	**Total £m**
Cost or valuation:										
At 1 January 2018	–	–	–		–	–	–	–		–
Acquisition of businesses	10	34	2		46	–	6	–		6
Additions	–	1	–		1	–	2	–		2
Disposals	–	(2)	(2)		(4)	–	–	–		–
At 31 December 2018	10	33	–		43	–	8	–		8
Adjustment on adoption of IFRS 16 (note 39)	–	–	–	72	72	–	–	–	56	56
Balance at 1 January 2019	**10**	**33**	**–**	**72**	**115**	**–**	**8**	**–**	**56**	**64**
Acquisition of businesses	**–**	**–**	**–**	**–**	**–**	**–**	**23**	**–**	**–**	**23**
Additions	**–**	**4**	**–**	**1**	**5**	**–**	**1**	**–**	**–**	**1**
Disposals	**–**	**(4)**	**–**	**(1)**	**(5)**	**–**	**(1)**	**–**	**–**	**(1)**
At 31 December 2019	**10**	**33**	**–**	**72**	**115**	**–**	**31**	**–**	**56**	**87**
Accumulated depreciation and impairment:										
At 1 January 2018	–	–	–		–	–	–	–		–
Acquisition of businesses	6	24	1		31	–	2	–		2
Charge for the year	–	2	–		2	–	–	–		–
Disposals	(1)	(3)	(1)		(5)	–	–	–		–
At 31 December 2018	5	23	–		28	–	2	–		2
Acquisition of businesses	**–**	**–**	**–**	**–**	**–**	**–**	**20**	**–**	**–**	**20**
Charge for the year	**2**	**5**	**–**	**12**	**19**	**–**	**2**	**–**	**9**	**11**
Disposals	**–**	**(4)**	**–**	**–**	**(4)**	**–**	**(1)**	**–**	**–**	**(1)**
At 31 December 2019	**7**	**24**	**–**	**12**	**43**	**–**	**23**	**–**	**9**	**32**
Balance sheet amount at 31 December 2019	**3**	**9**	**–**	**60**	**72**	**–**	**8**	**–**	**47**	**55**
Balance sheet amount at 31 December 2018	5	10	–	–	15	–	6	–	–	6

1 Primarily premises.

19 Investment in subsidiary undertakings of the Bank

	2019 £m	2018 £m
At 1 January	**908**	–
Additions and capital injections	**27**	908
Disposals	**–**	–
Impairment	**(640)**	–
At 31 December	**295**	908

All subsidiary entities were acquired during the prior reporting period as part of the Lloyds Banking Group strategy to create a ring-fenced bank.

During the year, £27 million was further invested in Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH.

The Bank's interest in each of these entities is in the form of ordinary share capital.

Details of the subsidiaries and related undertakings are given in note 42 and are incorporated by reference.

On 2nd December 2019, the business and the majority of the assets and liabilities of the Bank's subsidiary, Lloyds Bank International Limited ("LBIL"), were transferred to the Bank. This gave rise to the Company acquiring net liabilities of £6.1 billion. The transfer was made by way of:-

- A transfer scheme pursuant to Section 3A of and Schedule 1A to the Financial Services Act 2008 approved by the High Court of Justice of the Isle of Man on 25 November 2019 in relation to the transfer of the Company's Isle of Man branch to LBCM Isle of Man branch
- An application pursuant to Article 48D of and the Schedule to the Banking Business (Jersey) Law 1991 approved in the Royal Court of Jersey on 20 November 2019 in relation to the transfer of the business of the Company's Jersey branch to LBCM's Jersey branch
- A Business Transfer Agreement ("BTA") between Lloyds Bank International Limited and Lloyds Bank Corporate Markets plc relating to the transfer of the business of the Company's, Guernsey Branch, to the Guernsey branch of LBCM's Guernsey Branch dated 29 November 2019
- A Global Transfer Deed dated 29 November 2019 between the Company and LBCM in addition to the Schemes and the Guernsey BTA in respect of certain specific assets

In relation to the transfer LBIL paid a dividend of £811 million. Subsequent to the transfer and the dividend an impairment review was undertaken of the investment in subsidiary resulting in a write down of £640 million.

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

20 Other assets

	The Group		The Bank	
	2019 £m	2018 £m	2019 £m	2018 £m
Settlement balances	**69**	474	**67**	474
Other assets and prepayments	**46**	84	**38**	59
	115	558	**105**	533

21 Deferred taxation

The movement in the Deferred tax asset is as follows:

	The Group		The Bank	
	2019 £m	2018 £m	2019 £m	2018 £m
Brought forward	**6**	–	**4**	–
Credit/(charge) for the year (see note 10)	**11**	(2)	**1**	1
Transfers from other group undertakings	**–**	5	**–**	–
	17	3	**5**	1
Amount (charged)/credited to equity				
– Cash flow hedges	**(7)**	(1)	**1**	(1)
– Fair value through other comprehensive income	**(4)**	4	**(4)**	4
– Other	**–**	–	**–**	–
At 31 December	**6**	6	**2**	4

21 Deferred taxation (continued)

The movement in the Deferred tax liability is as follows:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Brought forward	**–**	–	**–**	–
Charge for the year (see note 10)	**(10)**	–	**–**	–
Transfers from other group undertakings	**–**	–	**–**	–
	(10)	–	**–**	–
Amount (charged)/credited to equity				
– Cash flow hedges	**(11)**	–	**(19)**	–
– Fair value through other comprehensive income	**3**	–	**3**	–
– Other	**–**	–	**–**	–
At 31 December	**(18)**	–	**(16)**	–

The deferred tax (credit)/charge in the Consolidated income statement comprises the following temporary differences:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Accelerated capital allowances	**2**	2	**–**	–
Tax losses carried forward	**(3)**	1	**(1)**	(1)
Other temporary differences	**–**	(1)	**–**	–
	(1)	2	**(1)**	(1)

The Deferred tax asset comprises:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Accelerated capital allowances	**–**	(9)	**–**	–
Tax losses carried forward	**4**	1	**2**	1
Subsidiary pension scheme	**2**	2	**–**	–
Cash flow hedges	**–**	7	**–**	(1)
Fair value through other comprehensive income	**–**	4	**–**	4
Other temporary differences	**–**	1	**–**	–
At 31 December	**6**	6	**2**	4

The Deferred tax liability comprises:

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Accelerated capital allowances	**(11)**	–	**–**	–
Tax losses carried forward	**–**	–	**–**	–
Subsidiary pension scheme	**–**	–	**–**	–
Cash flow hedges	**(11)**	–	**(19)**	–
Fair value through other comprehensive income	**3**	–	**3**	–
Other temporary differences	**1**	–	**–**	–
At 31 December	**(18)**	–	**(16)**	–

The Group measures its deferred tax assets and liabilities using the tax rates that are expected to apply when the asset is settled or the liability recovered based on the laws that have been enacted, or substantively enacted, at the reporting date. Deferred tax balances are re-measured at each reporting date based on the most recent estimates of utilisation or settlement, including the impact of bank surcharge where appropriate. As a result of legislation enacted in 2016, the UK corporation tax rate reduces from 19 per cent to 17 per cent from 1 April 2020. However, within the March 2020 Budget, the UK government stated its intention to maintain the corporation tax rate at 19 per cent from 1 April 2020.

The effect of this proposed rate change on the Group's and the Bank's deferred tax balances is estimated to be insignificant.

22 Financial liabilities at fair value through profit or loss

The Group and the Bank	2019 £m	2018 £m
Liabilities designated at fair value through profit or loss: debt securities in issue	–	1,062
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	11,047	11,440
Other deposits	1	10
Short positions in securities	2,736	1,496
	13,784	12,946
Financial liabilities at fair value through profit or loss	13,784	14,008

At 31 December 2019, the Group and the Bank had £2,630 million (2018: £1,308 million) of trading and other liabilities at fair value through profit or loss with a contractual residual maturity of greater than one year.

For the fair value of collateral pledged in respect of repurchase agreements see note 32.

23 Debt securities in issue

The Group and the Bank	2019 £m	2018 £m
Medium-term notes issued	2,208	45
Certificates of deposit issued	5,674	5,353
Commercial paper	957	1,162
Amounts due to fellow Group undertakings	3,590	6,382
Total debt securities in issue	12,429	12,942

At 31 December 2019 £2,578 million (2018: £7,316 million) of debt securities in issue of the Group and of the Bank had a contractual residual maturity of greater than one year.

24 Other liabilities

	The Group		The Bank	
	2019 £m	2018 £m	2019 £m	2018 £m
Settlement balances	390	342	390	342
Lease liabilities (see below)	65	–	48	–
Other creditors and accruals	122	87	112	59
	577	429	550	401

The maturity of the lease liabilities was as follows

	The Group		The Bank	
	2019 £m	2018 £m	2019 £m	2018 £m
Not later than 1 year	3	–	–	–
Later than 1 year and not later than 2 years	2	–	–	–
Later than 2 years and not later than 3 years	16	–	14	–
Later than 3 years and not later than 4 years	2	–	1	–
Later than 4 years and not later than 5 years	2	–	1	–
Later than 5 years	40	–	32	–
	65	–	48	–

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

25 Subordinated liabilities

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

The Group and the Bank	Dated subordinated 2019 £m	Dated subordinated 2018 £m
At 1 January	**725**	–
Issued during the year	**–**	696
Repurchases and redemptions during the year	**–**	–
Foreign exchange movements	**(27)**	26
Other movements	**–**	3
At 31 December	**698**	725

Issued during the year	Dated subordinated 2019 £m	Dated subordinated 2018 £m
Dated Subordinated Liabilities:		
Euro Floating Rate Notes 2028 callable 2023	**–**	264
Euro Floating Rate Notes 2030 callable 2025	**–**	301
US$ Floating Rate Notes 2033 callable 2028	**–**	131

26 Share capital

The Group and the Bank	2019 £m	2018 £m
Allotted, issued and fully paid		
120,050,000 (2018: 120,050,000) ordinary shares of £1 each	**120**	120

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).

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.

27 Other reserves

	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Other reserves comprise:				
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**(9)**	(7)	**(9)**	(7)
Cash flow hedging reserve	**56**	5	**56**	5
Foreign currency translation reserve	**(15)**	(13)	**(16)**	(15)
At 31 December	**32**	(15)	**31**	(17)

27 Other reserves (continued)

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	**(7)**	–	**(7)**	–
Change in fair value	**(1)**	(1)	**(1)**	(1)
Transfers in	**–**	(10)	**–**	(10)
Deferred Tax	**(1)**	–	**(1)**	–
Current Tax	**–**	–	**–**	–
	(2)	(11)	**(2)**	(11)
Realised gains and losses transferred to other comprehensive income				
Disposals	**–**	–	**–**	–
Deferred Tax	**–**	4	**–**	4
Current Tax	**–**	–	**–**	–
	–	4	**–**	4
At 31 December	**(9)**	(7)	**(9)**	(7)

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Cash flow hedging reserve				
At 1 January	**5**	–	**5**	–
Change in fair value of hedging derivatives	**78**	6	**78**	6
Deferred Tax	**(20)**	–	**(20)**	–
	58	6	**58**	6
Income statement transfers	**(9)**	–	**(9)**	–
Deferred Tax	**2**	(1)	**2**	(1)
	(7)	(1)	**(7)**	(1)
At 31 December	**56**	5	**56**	5

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Foreign currency translation reserve				
At 1 January	**(13)**	–	**(15)**	–
Currency translation differences arising in the year	**(2)**	2	**(1)**	–
Foreign currency losses on net investment hedges (tax: £nil)	**–**	–	**–**	–
Opening reserves adjustment in respect of foreign currency translation reserve	**–**	(15)	**–**	(15)
At 31 December	**(15)**	(13)	**(16)**	(15)

28 Retained proifts

	The Group		The Bank	
	2019 £m	2018[1] £m	**2019 £m**	2018[1] £m
At 1 January	**3,105**	–	**3,087**	–
Profit for the year[2]	**283**	160	**397**	113
Distributions on other equity instruments	**(49)**	(25)	**(49)**	(25)
Opening reserves adjustment in respect of foreign currency translation reserve	**–**	15	**–**	15
Opening reserves adjustment in respect of other transfers	**–**	(20)	**–**	9
Capital contribution received[3]	**–**	2,975	**–**	2,975
Other adjustments	**3**	–	**7**	–
At 31 December	**3,342**	3,105	**3,442**	3,087

1 Restated, see note 1.

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

3 During the period £nil in capital contributions were received from a related undertaking and recognised through retained earnings (2018: £2,975 million).

29 Other equity instruments

The Group and the Bank	**2019 £m**	2018 £m
At 1 January and 31 December	**782**	782

The Bank has in issue £782 million of Dollar and Euro Additional Tier 1 (AT1) securities to Lloyds Banking Group plc. The AT1 securities are floating rate 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 fixed rate reset 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 fixed rate reset AT1 securities will bear interest at rates fixed periodically in advance. The floating rate AT1 securities will be reset quarterly both prior to and following the first call date
- 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 Prudential Regulation Authority
- 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

30 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 and Bank's key management personnel are the members of the Lloyds Bank Corporate Markets plc board.

The table below represents key management personnel emoluments.

	2019 £'000	2018 £'000
Salaries and other short term employee benefits	**2,773**	2,353
Post employment benefits	**34**	17
Total compensation	**2,807**	2,370

The amounts disclosed above relate wholly to directors of the Group.

Balances and transactions with fellow Lloyds Banking Group undertakings
Balances and transactions between members of the Lloyds Bank Corporate Markets Group
In accordance with IFRS 10 *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:

30 Related party transactions (continued)

	2019 £m	2018 £m
Assets, included within:		
Derivative financial instruments	**56**	57
Financial assets at fair value through profit or loss	**–**	–
Financial assets at amortised cost: due from fellow Lloyds Bank Corporate Markets Group undertakings	**388**	418
Financial assets at fair value through other comprehensive income	**–**	–
	444	475
Liabilities, included within:		
Due to fellow Lloyds Bank Corporate Markets Group undertakings	**506**	4,951
Financial liabilities at fair value through profit or loss	**–**	–
Derivative financial instruments	**–**	–
Debt securities in issue	**–**	–
Subordinated liabilities	**–**	–
	506	4,951

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 £9 million (2018: £4 million) and incurred interest expense on the above liability balances of £67 million (2018: £25 million).

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

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Assets, included within:				
Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings	**710**	6,593	**431**	967
Financial assets at fair value through profit or loss	**40**	261	**40**	261
Derivative financial instruments	**2,734**	2,936	**2,734**	2,936
	3,484	9,790	**3,205**	4,164
Liabilities, included within:				
Due to fellow Lloyds Banking Group undertakings	**1,638**	1,794	**1,578**	1,550
Financial liabilities at fair value through profit or loss	**–**	1,065	**–**	1,065
Derivative financial instruments	**2,254**	3,496	**2,254**	3,496
Debt securities in issue	**3,590**	6,382	**3,590**	6,382
Subordinated liabilities	**698**	725	**698**	725
	8,180	13,462	**8,120**	13,218
Other equity instruments				
Additional tier 1 instruments	**782**	782	**782**	782
	782	782	**782**	782

These balances include the Group's banking arrangements and, due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2019 the Group earned £45 million and the Bank earned £9 million interest income on the above asset balances (2018: Group £57 million, Bank £12 million); the Group incurred £201 million and the Bank incurred £200 million interest expense on the above liability balances (2018: Group £113 million, Bank £117 million).

The Group earned £92 million and the Bank earned £88 million of Fee and Commission Income (2018: Group £100 million, Bank £95 million); the Group incurred £18 million and the Bank incurred £18 million of Fee and Commission Expense (2018: Group £20 million, Bank £21 million), both in respect of transactions with Lloyds Bank plc.

31 Contingent liabilities, capital commitments and guarantees

Contingent liabilities	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Acceptances and endorsements	**57**	163	**57**	163
Other:				
Other items serving as direct credit substitutes	**86**	147	**86**	147
Performance bonds and other transaction-related contingencies	**180**	155	**180**	155
	266	302	**266**	302
Total contingent liabilities	**323**	465	**323**	465

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

Commitments and guarantees	The Group 2019 £m	The Group 2018 £m	The Bank 2019 £m	The Bank 2018 £m
Forward asset purchases and forward deposits placed	**19**	–	**19**	–
Undrawn formal standby facilities, credit line and other commitments to lend:				
Less than 1 year original maturity:				
Mortgage offers made	**37**	21	**37**	–
Other commitments and guarantees	**7,319**	7,026	**7,319**	6,325
	7,356	7,047	**7,356**	6,325
More than 1 year original maturity – 3rd party	**9,347**	9,499	**9,287**	9,041
Total commitments and guarantees	**16,722**	16,546	**16,662**	15,366

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £16,589 million for the Group (2018: £16,464 million) and £16,528 million for the Bank were irrevocable (2018: £15,366 million).

There were no contracted capital commitments at the Balance sheet date.

32 Financial instruments

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

		Mandatorily held at fair value through profit or loss					
The Group	**Derivatives designated as hedging instruments £m**	**Held for trading £m**	**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	–	–	–	–	–	16,250	16,250
Items in the course of collection from banks	–	–	–	–	–	21	21
Financial assets at fair value through profit or loss	–	17,732	414	–	–	–	18,146
Derivative financial instruments	15	18,821	–	–	–	–	18,836
Loans and advances to banks	–	–	–	–	–	4,813	4,813
Loans and advances to customers	–	–	–	–	–	20,264	20,264
Debt securities	–	–	–	–	–	112	112
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	710	710
Financial assets at amortised cost	–	–	–	–	–	25,899	25,899
Financial assets at fair value through other comprehensive income	–	–	–	–	314	–	314
Total financial assets	15	36,553	414	–	314	42,170	79,466
Financial liabilities							
Deposits from banks	–	–	–	–	–	3,970	3,970
Customer deposits	–	–	–	–	–	24,479	24,479
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	1,638	1,638
Financial liabilities at fair value through profit or loss	–	13,784	–	–	–	–	13,784
Derivative financial instruments	6	17,756	–	–	–	–	17,762
Debt securities in issue	–	–	–	–	–	12,429	12,429
Subordinated liabilities	–	–	–	–	–	698	698
Total financial liabilities	6	31,540	–	–	–	43,214	74,760

32 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	–	–	–	–	–	14,448	14,448
Items in the course of collection from banks	–	–	–	–	–	2	2
Financial assets at fair value through profit or loss	–	17,089	82	–	–	–	17,171
Derivative financial instruments	–	15,867	–	–	–	–	15,867
Loans and advances to banks	–	–	–	–	–	2,583	2,583
Loans and advances to customers	–	–	–	–	–	20,684	20,684
Debt securities	–	–	–	–	–	132	132
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	6,593	6,593
Financial assets at amortised cost	–	–	–	–	–	29,992	29,992
Financial assets at fair value through other comprehensive income	–	–	–	–	412	–	412
Total financial assets	–	32,956	82	–	412	44,442	77,892
Financial liabilities							
Deposits from banks	–	–	–	–	–	3,177	3,177
Customer deposits	–	–	–	–	–	26,870	26,870
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	1,794	1,794
Financial liabilities at fair value through profit or loss	–	12,946	–	1,062	–	–	14,008
Derivative financial instruments	–	14,511	–	–	–	–	14,511
Debt securities in issue	–	–	–	–	–	12,942	12,942
Subordinated liabilities	–	–	–	–	–	725	725
Total financial liabilities	–	27,457	–	1,062	–	45,508	74,027

32 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	–	–	–	–	–	16,250	16,250
Items in the course of collection from banks	–	–	–	–	–	21	21
Financial assets at fair value through profit or loss	–	17,732	327	–	–	–	18,059
Derivative financial instruments	15	18,877	–	–	–	–	18,892
Loans and advances to banks	–	–	–	–	–	4,792	4,792
Loans and advances to customers	–	–	–	–	–	19,986	19,986
Debt securities	–	–	–	–	–	112	112
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	819	819
Financial assets at amortised cost	–	–	–	–	–	25,709	25,709
Financial assets at fair value through other comprehensive income	–	–	–	–	314	–	314
Total financial assets	15	36,609	327	–	314	41,980	79,245
Financial liabilities							
Deposits from banks	–	–	–	–	–	3,970	3,970
Customer deposits	–	–	–	–	–	24,010	24,010
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	2,084	2,084
Financial liabilities at fair value through profit or loss	–	13,784	–	–	–	–	13,784
Derivative financial instruments	6	17,756	–	–	–	–	17,762
Debt securities in issue	–	–	–	–	–	12,429	12,429
Subordinated liabilities	–	–	–	–	–	698	698
Total financial liabilities	6	31,540	–	–	–	43,191	74,737

32 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	–	–	–	–	–	14,441	14,441
Financial assets at fair value through profit or loss	–	17,089	3	–	–	–	17,092
Derivative financial instruments	–	15,921	–	–	–	–	15,921
Loans and advances to banks	–	–	–	–	–	2,561	2,561
Loans and advances to customers	–	–	–	–	–	17,036	17,036
Debt securities	–	–	–	–	–	132	132
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	–	1,388	1,388
Financial assets at amortised cost	–	–	–	–	–	21,117	21,117
Financial assets at fair value through other comprehensive income	–	–	–	–	412	–	412
Total financial assets	–	33,010	3	–	412	35,558	68,983
At 31 December 2018							
Financial liabilities							
Deposits from banks	–	–	–	–	–	3,176	3,176
Customer deposits	–	–	–	–	–	14,180	14,180
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–	6,501	6,501
Financial liabilities at fair value through profit or loss	–	12,946	–	1,062	–	–	14,008
Derivative financial instruments	–	14,510	–	–	–	–	14,510
Debt securities in issue	–	–	–	–	–	12,942	12,942
Subordinated liabilities	–	–	–	–	–	725	725
Total financial liabilities	–	27,456	–	1,062	–	37,524	66,042

32 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 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 the derivatives are managed.

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

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. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are 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.

32 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 £18,460 million (2018: £17,583 million). The table below analyses these financial assets by balance sheet classification, asset type and valuation methodology (level 1, 2 or 3, as described on page 69). 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
As at 31 December 2019				
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	10,422	326	10,748
Loans and advances to banks	–	513	–	513
Debt securities:				
Government securities	6,501	–	–	6,501
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	68	–	68
Asset-backed securities:				
Mortgage-backed securities	–	6	–	6
Other asset-backed securities	–	17	–	17
Corporate and other debt securities	–	274	–	274
	6,501	365	–	6,866
Treasury and other bills	19	–	–	19
Equity shares	–	–	–	–
Total financial assets at fair value through profit or loss	6,520	11,300	326	18,146
Financial assets at fair value through other comprehensive income				
Debt securities:				
Government securities	–	–	–	–
Bank and building society certificates of deposit	–	97	–	97
Asset-backed securities:				
Mortgage-backed securities	–	–	–	–
Other asset-backed securities	–	–	121	121
Corporate and other debt securities	–	–	–	–
	–	97	121	218
Treasury and other bills	96	–	–	96
Equity shares	–	–	–	–
Total financial assets at fair value through other comprehensive income	96	97	121	314
Total financial assets carried at fair value, excluding derivatives	6,616	11,397	447	18,460

32 Financial instruments (continued)

The Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31 December 2018				
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	11,295	3	11,298
Loans and advances to banks	–	612	–	612
Debt securities:				
Government securities	4,899	–	–	4,899
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	59	–	59
Asset-backed securities:				
Mortgage-backed securities	–	10	–	10
Other asset-backed securities	–	43	–	43
Corporate and other debt securities	–	230	–	230
	4,899	342	–	5,241
Equity shares	–	–	–	–
Treasury and other bills	20	–	–	20
Total financial assets at fair value through profit or loss	4,919	12,249	3	17,171
Financial assets at fair value through other comprehensive income				
Debt securities:				
Government securities	–	–	–	–
Bank and building society certificates of deposit	–	136	–	136
Asset-backed securities:				–
Mortgage-backed securities	–	–	–	–
Other asset-backed securities	–	–	121	121
Corporate and other debt securities	–	–	73	73
	–	136	194	330
Treasury and other bills	–	–	–	–
Equity shares	82	–	–	82
Total financial assets at fair value through other comprehensive income	82	136	194	412
Total financial assets carried at fair value, excluding derivatives	5,001	12,385	197	17,583

32 Financial instruments (continued)

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31 December 2019				
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	10,422	326	10,748
Loans and advances to banks	–	513	–	513
Debt securities:				
Government securities	6,501	–	–	6,501
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	–	–	–
Asset-backed securities:				
Mortgage-backed securities	–	6	–	6
Other asset-backed securities	–	17	–	17
Corporate and other debt securities	–	274	–	274
	6,501	297	–	6,798
Equity shares	–	–	–	–
Treasury and other bills	–	–	–	–
Total financial assets at fair value through profit or loss	6,501	11,232	326	18,059
Financial assets at fair value through other comprehensive income				
Debt securities:				
Government securities	–	–	–	–
Bank and building society certificates of deposit	–	97	–	97
Asset-backed securities:				
Mortgage-backed securities	–	–	–	–
Other asset-backed securities	–	–	121	121
Corporate and other debt securities	–	–	–	–
	–	97	121	218
Equity shares	–	–	–	–
Treasury and other bills	96	–	–	96
Total financial assets at fair value through other comprehensive income	96	97	121	314
Total financial assets carried at fair value, excluding derivatives	6,597	11,329	447	18,373

32 Financial instruments (continued)

The Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31 December 2018				
Financial assets at fair value through profit or loss				
Loans and advances to customers	–	11,295	3	11,298
Loans and advances to banks	–	612	–	612
Debt securities:				
Government securities	4,898	–	–	4,898
Other public sector securities	–	–	–	–
Bank and building society certificates of deposit	–	–	–	–
Asset-backed securities:				
Mortgage-backed securities	–	10	–	10
Other asset-backed securities	–	43	–	43
Corporate and other debt securities	–	231	–	231
	4,898	284	–	5,182
Equity shares	–	–	–	–
Treasury and other bills	–	–	–	–
Total financial assets at fair value through profit or loss	4,898	12,191	3	17,092
Financial assets at fair value through other comprehensive income				
Debt securities:				
Government securities	–	–	–	–
Bank and building society certificates of deposit	–	136	–	136
Asset-backed securities:				
Mortgage-backed securities	–	–	–	–
Other asset-backed securities	–	–	121	121
Corporate and other debt securities	–	–	73	73
	–	136	194	330
Equity shares	–	–	–	–
Treasury and other bills	82	–	–	82
Total financial assets at fair value through other comprehensive income	82	136	194	412
Total financial assets carried at fair value, excluding derivatives	4,980	12,327	197	17,504

Movements in level 3 portfolio
The table below analyses movements in level 3 financial assets, excluding derivatives, carried at fair value:

	2019			2018		
The Group and the Bank	**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 £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 £m
Opening balance	**3**	**194**	**197**	–	–	–
Exchange and other adjustments	**–**	**(7)**	**(7)**	1	–	1
(Losses) gains recognised in other comprehensive income within the revaluation reserves in respect of financial assets at fair value through other comprehensive income	**–**	**1**	**1**	(1)	–	(1)
Purchases	**633**	**–**	**633**	3	194	197
Sales	**(310)**	**(86)**	**(396)**	–	–	–
Transfers into the level 3 portfolio	**–**	**19**	**19**	–	–	–
At 31 December	**326**	**121**	**447**	3	194	197
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**–**	**7**	**7**	–	–	–

32 Financial instruments (continued)

Valuation methodology for financial assets, excluding derivatives

Loans and advances to customers and banks

These assets are principally reverse repurchase agreements. The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from observable repo curves specific to the type of security purchased under the reverse repurchase agreement.

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.

(B) Financial liabilities, excluding derivatives

Valuation hierarchy

At 31 December 2019, the Group's financial liabilities carried at fair value, excluding derivatives, totalled £13,784 million (2018: £14,008 million). The table below analyses these financial liabilities by balance sheet classification, liability type and valuation methodology (level 1, 2 or 3, as described on page 69). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

The Group and the Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
As at 31 December 2019				
Financial liabilities at fair value through profit or loss				
Liabilities designated at fair value through profit or loss	–	–	–	–
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	**11,047**	–	**11,047**
Short positions in securities	**2,708**	**28**	–	**2,736**
Other deposits	–	**1**	–	**1**
Total Trading liabilities	**2,708**	**11,076**	–	**13,784**
Total financial liabilities carried at fair value, excluding derivatives	**2,708**	**11,076**	–	**13,784**

The Group and the Bank	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31 December 2018				
Financial liabilities at fair value through profit or loss				
Liabilities designated at fair value through profit or loss	–	1,062	–	1,062
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	11,440	–	11,440
Short positions in securities	1,397	99	–	1,496
Other deposits	–	10	–	10
Total Trading liabilities	1,397	11,549	–	12,946
Total financial liabilities carried at fair value, excluding derivatives	1,397	12,611	–	14,008

Movements in level 3 portfolio

There have been no movements in level 3 financial liabilities, excluding derivatives, carried at fair value during the year.

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.

32 Financial instruments (continued)

(C) Derivatives

All the Group's derivative assets and liabilities are carried at fair value. At 31 December 2019 such assets totalled £18,836 million for the Group and £18,892 million for the Bank (2018: £15,867 million for the Group and £15,921 million for the Bank) and liabilities totalled £17,762 million for the Group and £17,762 million for the Bank (2018: £14,511 million for the Group and £14,510 million for the Bank). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 69). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

	2019				2018			
The Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	**5**	**18,046**	**785**	**18,836**	4	14,941	922	15,867
Derivative liabilities	**18**	**16,674**	**1,070**	**17,762**	–	13,804	707	14,511

	2019				2018			
The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	**5**	**18,102**	**785**	**18,892**	4	14,995	922	15,921
Derivative liabilities	**18**	**16,674**	**1,070**	**17,762**	–	13,803	707	14,510

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.

Movements in level 3 portfolio

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

	2019		2018	
The Group and the Bank	**Derivative assets £m**	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	**922**	**707**	–	–
Gains recognised in the income statement within other income	**81**	**75**	–	68
Purchases	**4**	**4**	922	639
Sales	**(19)**	**–**	–	–
Exchange and other adjustments	**(25)**	**(4)**	–	–
Transfers into the level 3 portfolio	**336**	**616**	–	–
Transfers out of the level 3 portfolio	**(514)**	**(328)**	–	–
At 31 December	**785**	**1,070**	922	707
(Losses)/gains in the income statement, within other income, relating to the change in fair value of those assets or liabilities at 31 December	**(13)**	**18**	–	–

32 Financial instruments (continued)

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 2018 and 2019.

Uncollateralised derivative valuation adjustments	2019 £m	2018 £m
At 1 January	**310**	–
Transfers (out)/in	**(3)**	225
Income statement (credit)/charge	**(112)**	85
At 31 December	**195**	310

Represented by:	2019 £m	2018 £m
Credit Valuation Adjustment (CVA)	**142**	271
Debit Valuation Adjustment (DVA)	**(34)**	(97)
Funding Valuation Adjustment	**87**	136
	195	310

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 collateral arrangements (CSAs). These adjustments reflect the level of interest rates, foreign exchange rates, expectations of counterparty creditworthiness and the Group's own credit spread respectively.

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
- expectations of counterparty creditworthiness

In circumstances where exposures to a counterparty becomes credit impaired, any associated derivative valuation adjustment is transferred and assessed for specific loss alongside other non-derivative assets and liabilities that the counterparty may have with the Group.

Market Credit Default Swap (CDS) spreads are used to develop the probability of default for quoted counterparties. For unquoted counterparties, internal credit ratings and market sector CDS curves and recovery rates are used. The Loss Given Default (LGD) is based on market recovery rates and internal credit assessments.

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 £28.4 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (in total contributing £nil of the overall CVA balance 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
- the Group's own implied CDS spread

A one per cent rise in the CDS spread would lead to an increase in the DVA of £77.6 million to £111.6 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates and foreign exchange rates. Due to the nature of the Group's business and client hedging needs, CVA/DVA exposures and valuation adjustments tend to fall when interest rates rise. A one per cent rise in interest rates would lead to a £20.9 million fall in the overall valuation adjustment to £87.8 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 £11.4 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 £57.8 million (2018: £62.5 million).

32 Financial instruments (continued)

(D) Sensitivity of level 3 valuations

The Group and the Bank			**At 31 December 2019**			At 31 December 2018		
				Effect of reasonably possible alternative assumptions[2]			Effect of reasonably possible alternative assumptions[2]	
	Valuation technique(s)	**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	Comparable Pricing	Spread	**326**	**3**	**(3)**	3	–	–
			326	**3**	**(3)**	3	–	–
Financial Assets at fair value through other comprehensive income								
Asset-backed securities	Comparable Pricing	Price	**103**	**2**	**(2)**	121	–	(1)
	Comparable Pricing	Spread	**18**	**–**	**–**	–	–	–
	Comparable Pricing	Price	**–**	**–**	**–**	73	3	(3)
			121	**2**	**(2)**	194	3	(4)
Derivative financial assets								
Interest rate derivatives	Option pricing model	Inflation Volatility	**330**	**3**	**(3)**	311	3	(3)
	Option pricing model	Interest Rate Volatility	**455**	**–**	**(1)**	611	3	(2)
			785	**3**	**(4)**	922	6	(5)
Level 3 financial assets carried at fair value			**1,232**	**8**	**(9)**	1,119	9	(9)
Derivative financial liabilities								
Interest rate derivatives	Option pricing model	Inflation Volatility	**(260)**	**–**	**–**	(237)	–	–
	Option pricing model	Interest Rate Volatility	**(810)**	**–**	**–**	(470)	–	–
			(1,070)	**–**	**–**	(707)	–	–
Level 3 financial liabilities carried at fair value			**(1,070)**	**–**	**–**	(707)	–	–

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.

Unobservable inputs

Significant unobservable inputs affecting the valuation of debt securities 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

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.

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 have been flexed within a range of 14 per cent to 115 per cent (2018: 0 per cent to 124 per cent).

32 Financial instruments (continued)

(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 which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 69). Financial assets carried at amortised cost 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**
As at 31 December 2019					
Loans and advances to customers	**20,264**	**20,418**	**–**	**2,976**	**17,442**
Loans and advances to banks	**4,813**	**4,815**	**–**	**1,148**	**3,667**
Debt securities	**112**	**112**	**–**	**112**	**–**
Due from fellow Lloyds Banking Group undertakings	**710**	**710**	**–**	**–**	**710**
Reverse repos included in above amounts:					
Loans and advances to customers	**2,976**	**2,976**	–	**2,976**	–
Loans and advances to banks	**1,148**	**1,148**	–	**1,148**	–
As at 31 December 2018					
Loans and advances to customers	20,684	20,701	–	4,604	16,097
Loans and advances to banks	2,583	2,583	–	–	2,583
Debt securities	132	127	–	127	–
Due from fellow Lloyds Banking Group undertakings	6,593	6,593	–	–	6,593
Reverse repos included in above amounts:					
Loans and advances to customers	4,604	4,604	–	4,604	–
Loans and advances to banks	–	–	–	–	–

			Valuation hierarchy		
The Bank	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
As at 31 December 2019					
Loans and advances to customers	**19,986**	**20,139**	**–**	**2,976**	**17,163**
Loans and advances to banks	**4,792**	**4,792**	**–**	**1,148**	**3,644**
Debt securities	**112**	**112**	**–**	**112**	**–**
Due from fellow Lloyds Banking Group undertakings	**819**	**819**	**–**	**–**	**819**
Reverse repos included in above amounts:					
Loans and advances to customers	**2,976**	**2,976**	**–**	**2,976**	**–**
Loans and advances to banks	**1,148**	**1,148**	**–**	**1,148**	**–**
As at 31 December 2018					
Loans and advances to customers	17,036	17,051	–	4,604	12,447
Loans and advances to banks	2,561	2,561	–	–	2,561
Debt securities	132	127	–	127	–
Due from fellow Lloyds Banking Group undertakings	1,388	1,388	–	–	1,388
Reverse repos included in above amounts:					
Loans and advances to customers	4,604	4,604	–	4,604	–
Loans and advances to banks	–	–	–	–	–

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 estimated to be their fair value.

32 Financial instruments (continued)

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 estimated 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 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 considered a reasonable approximation of fair value given the short-term nature of these instruments.

(B) Financial liabilities

Valuation hierarchy
The table below analyses fair values of the financial liabilities of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 69).

			Valuation hierarchy		
The Group	**Carrying value £m**	**Fair value £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
As at 31 December 2019					
Deposits from banks	**3,970**	**3,965**	**–**	**3,965**	**–**
Customer deposits	**24,479**	**24,504**	**–**	**24,504**	**–**
Due to fellow Lloyds Banking Group undertakings	**1,638**	**1,638**	**–**	**1,638**	**–**
Debt securities in issue	**12,429**	**12,329**	**–**	**12,329**	**–**
Subordinated liabilities	**698**	**698**	**–**	**698**	**–**
Repos included in above amounts:					
Deposits from banks	**–**	**–**	**–**	**–**	**–**
Customer deposits	**–**	**–**	**–**	**–**	**–**
Due to fellow Lloyds Banking Group undertakings	**–**	**–**	**–**	**–**	**–**
As at 31 December 2018					
Deposits from banks	3,177	3,196	–	3,196	–
Customer deposits	26,870	26,910	–	26,910	–
Due to fellow Lloyds Banking Group undertakings	1,794	1,794	–	1,794	–
Debt securities in issue	12,942	12,897	–	12,897	–
Subordinated liabilities	725	725	–	725	–
Repos included in above amounts:					
Deposits from banks	–	–	–	–	–
Customer deposits	372	372	–	372	–
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–

32 Financial instruments (continued)

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
As at 31 December 2019					
Deposits from banks	**3,970**	**3,965**	**–**	**3,965**	**–**
Customer deposits	**24,010**	**24,035**	**–**	**24,035**	**–**
Due to fellow Lloyds Banking Group undertakings	**2,084**	**2,084**	**–**	**2,084**	**–**
Debt securities in issue	**12,429**	**12,329**	**–**	**12,329**	**–**
Subordinated liabilities	**698**	**698**	**–**	**698**	**–**
Repos included in above amounts:					
Deposits from banks	**–**	**–**	**–**	**–**	**–**
Customer deposits	**–**	**–**	**–**	**–**	**–**
Due to fellow Lloyds Banking Group undertakings	**–**	**–**	**–**	**–**	**–**
As at 31 December 2018					
Deposits from banks	3,176	3,195	–	3,195	–
Customer deposits	14,180	14,226	–	14,226	–
Due to fellow Lloyds Banking Group undertakings	6,501	6,501	–	6,501	–
Debt securities in issue	12,942	12,897	–	12,897	–
Subordinated liabilities	725	725	–	725	–
Repos included in above amounts:					
Deposits from banks	–	–	–	–	–
Customer deposits	372	372	–	372	–
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	–

Valuation methodology

Deposits from banks and customer deposits

The fair value of bank and customer deposits repayable on demand is estimated 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.

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) Reclassifications of financial assets

There have been no reclassifications of financial assets in 2018 or 2019.

33 Business combinations

During the current year, the Bank acquired assets and liabilities from one of it's subsidiaries. See note 19 for further information.

During the prior year, the Group acquired 100 per cent of the voting equity instruments and obtained control of a number of fellow Lloyds Banking Group undertakings representing the element of their commercial banking businesses required to be transferred in order to ensure compliance with the Ring-fencing legislation for a total consideration of £13 billion. The legal entities transferred during the prior year are those listed in note 42 below. All entities transferred have remained under common control of the ultimate parent.

Consistent with predecessor accounting (refer note 3), the consideration paid was equal to book value and hence no goodwill or discount arose on acquisition. Total consideration was paid as cash.

The Bank did not dispose of any operations of the acquiree as part of either business combination. Predecessor accounting was applied prospectively as described in note 3.

34 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.

				Related amounts where set off in the balance sheet not permitted[3]		
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	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	7,211	–	7,211	–	(1,876)	5,335
Reverse repos	23,938	(13,003)	10,935	–	(10,935)	–
	31,149	(13,003)	18,146	–	(12,811)	5,335
Derivative financial instruments	18,836	–	18,836	(4,483)	(10,003)	4,350
Loans and advances to banks:						
Excluding reverse repos	3,665	–	3,665	(1,800)	–	1,865
Reverse repos	1,148	–	1,148	–	(1,148)	–
	4,813	–	4,813	(1,800)	(1,148)	1,865
Loans and advances to customers:						
Excluding reverse repos	17,288	–	17,288	(1,498)	–	15,790
Reverse repos	2,976	–	2,976	–	(2,976)	–
	20,264	–	20,264	(1,498)	(2,976)	15,790
Debt securities	112	–	112	–	–	112
Financial assets at fair value through other comprehensive income	314	–	314	–	–	314
Financial liabilities						
Deposits from banks:						
Excluding repos	3,970	–	3,970	(2,571)	–	1,399
Repos	–	–	–	–	–	–
	3,970	–	3,970	(2,571)	–	1,399
Customer deposits:						
Excluding repos	24,479	–	24,479	(1,912)	–	22,567
Repos	–	–	–	–	–	–
	24,479	–	24,479	(1,912)	–	22,567
Financial liabilities at fair value through profit or loss:						
Excluding repos	2,737	–	2,737	–	–	2,737
Repos	24,050	(13,003)	11,047	–	(11,047)	–
	26,787	(13,003)	13,784	–	(11,047)	2,737
Derivative financial instruments	17,762	–	17,762	(3,298)	(11,582)	2,882

34 Offsetting of financial assets and liabilities (continued)

				Related amounts where set off in the balance sheet not permitted[3]		
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	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	5,264	–	5,264	–	(1,418)	3,846
Reverse repos	16,259	(4,352)	11,907	–	(11,907)	–
	21,523	(4,352)	17,171	–	(13,325)	3,846
Derivative financial instruments	29,191	(13,324)	15,867	(3,143)	(10,150)	2,574
Loans and advances to banks:						
Excluding reverse repos	2,583	–	2,583	(1,179)	–	1,404
Reverse repos	–	–	–	–	–	–
	2,583	–	2,583	(1,179)	–	1,404
Loans and advances to customers:						
Excluding reverse repos	18,723	(2,643)	16,080	(456)	–	15,624
Reverse repos	4,604	–	4,604	–	(4,604)	–
	23,327	(2,643)	20,684	(456)	(4,604)	15,624
Debt securities	132	–	132	–	–	132
Financial assets at fair value through other comprehensive income	412	–	412	–	–	412
Financial liabilities						
Deposits from banks:						
Excluding repos	3,177	–	3,177	(2,067)	–	1,110
Repos	–	–	–	–	–	–
	3,177	–	3,177	(2,067)	–	1,110
Customer deposits:						
Excluding repos	26,611	(113)	26,498	(1,077)	–	25,421
Repos	372	–	372	–	–	372
	26,983	(113)	26,870	(1,077)	–	25,793
Financial liabilities at fair value through profit or loss:						
Excluding repos	1,506	–	1,506	–	–	1,506
Repos	16,855	(4,353)	12,502	(3,837)	(8,665)	–
	18,361	(4,353)	14,008	(3,837)	(8,665)	1,506
Derivative financial instruments	30,366	(15,855)	14,511	(1,635)	(2,687)	10,189

1 After impairment allowance.

2 The amounts set off in the balance sheet as shown above represent derivatives and repurchase agreements 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-collateralisation have not been taken into account in the above table.

35 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. 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. 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 and security, using master netting agreements and other credit risk transfers, such as asset sales and credit derivative based transactions.

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

	2019			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]	**4,813**	**–**	**4,813**	2,583	–	2,583
Loans and advances to customers, net[1]	**20,264**	**–**	**20,264**	20,684	(456)	20,228
Debt securities, net[1]	**112**	**–**	**112**	132	–	132
	25,189	**–**	**25,189**	23,399	(456)	22,943
Financial assets at fair value through other comprehensive income	**314**	**–**	**314**	412	–	412
Financial assets at fair value through profit or loss:						
Loans and advances	**11,261**	**–**	**11,261**	11,910	–	11,910
Debt securities, treasury and other bills	**6,885**	**–**	**6,885**	5,261	–	5,261
	18,146	**–**	**18,146**	17,171	–	17,171
Derivative assets	**18,836**	**(8,683)**	**10,153**	15,867	(8,343)	7,524
Off-balance sheet items:						
Acceptances and endorsements	**57**	**–**	**57**	163	–	163
Other items serving as direct credit substitutes	**86**	**–**	**86**	147	–	147
Performance bonds and other transaction-related contingencies	**180**	**–**	**180**	155	–	155
Irrevocable commitments and guarantees	**16,589**	**–**	**16,589**	16,464	–	16,464
	16,912	**–**	**16,912**	16,929	–	16,929
	79,397	**(8,683)**	**70,714**	73,778	(8,799)	64,979

35 Financial risk management (continued)

The Bank	2019 Maximum exposure £m	2019 Offset[2] £m	2019 Net exposure £m	2018 Maximum exposure £m	2018 Offset[2] £m	2018 Net exposure £m
Loans and advances to banks, net[1]	**4,792**	**–**	**4,792**	2,561	–	2,561
Loans and advances to customers, net[1]	**19,986**	**–**	**19,986**	17,036	(456)	16,580
Debt securities, net[1]	**112**	**–**	**112**	132	–	132
	24,890	**–**	**24,890**	19,729	(456)	19,273
Financial assets at fair value through other comprehensive income	**314**	**–**	**314**	412	–	412
Financial assets at fair value through profit or loss:						
Loans and advances	**11,261**	**–**	**11,261**	11,910	–	11,910
Debt securities, treasury and other bills	**6,798**	**–**	**6,798**	5,182	–	5,182
	18,059	**–**	**18,059**	17,092	–	17,092
Derivative assets	**18,892**	**(8,683)**	**10,209**	15,867	(8,343)	7,524
Off-balance sheet items:						
Acceptances and endorsements	**57**	**–**	**57**	163	–	163
Other items serving as direct credit substitutes	**86**	**–**	**86**	147	–	147
Performance bonds and other transaction-related contingencies	**180**	**–**	**180**	155	–	155
Irrevocable commitments and guarantees	**16,528**	**–**	**16,528**	15,366	–	15,366
	16,851	**–**	**16,851**	15,831	–	15,831
	79,006	**(8,683)**	**70,323**	68,931	(8,799)	60,132

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.

35 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 most significant concentrations of exposure were in Financial, business and other services (comprising 81 per cent of total loans and advances to customers) and to Manufacturing (comprising 6 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	**1**	7	**1**	–
Energy and water supply	**9**	160	**9**	160
Manufacturing	**1,224**	1,564	**1,224**	1,556
Construction	**96**	216	**96**	9
Transport, distribution and hotels	**359**	181	**359**	166
Postal and telecommunications	**243**	316	**243**	311
Property companies	**877**	1,172	**877**	1,088
Financial, business and other services	**16,396**	16,160	**16,396**	13,836
Personal:				
Mortgages	**845**	707	**845**	–
Other	**107**	83	**21**	–
Lease financing	**135**	136	**–**	–
Hire purchase	**58**	81	**–**	–
Total loans and advances to customers before allowance for impairment losses	**20,350**	20,783	**20,071**	17,126
Allowance for impairment losses (note 16)	**(86)**	(101)	**(85)**	(90)
Total loans and advances to customers	**20,264**	20,682	**19,986**	17,036

C. Credit quality of assets

Loans and advances

The analysis of lending has been prepared with the business segment in which the exposure is recorded reflected in the ratings system applied. The internal credit ratings systems used by the Group for commercial business reflects 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.

	Corporate	
	Grade	IFRS 9 PD%
Good quality	**1-10**	0.00-0.50
Satisfactory quality	**11-14**	0.51-3.00
Lower quality	**15-18**	3.01–20.00
Below standard	**19**	20.01–99.99
Credit impaired	**20-23**	100

35 Financial risk management (continued)

The Group Gross carrying amount	2019 Loans and advances to banks £m	2019 Loans and advances to customers £m	2018 Loans and advances to banks £m	2018 Loans and advances to customers £m
Stage 1				
Good quality	4,814	19,611	2,583	19,594
Satisfactory quality	–	414	–	712
Lower quality	–	3	–	153
Below standard, but not credit-impaired	–	–	–	–
	4,814	20,028	2,583	20,459
Stage 2				
Good quality	–	9	–	–
Satisfactory quality	–	5	–	1
Lower quality	–	15	–	22
Below standard, but not credit-impaired	–	–	–	–
	–	29	–	23
Stage 3				
Credit-impaired	–	293	–	303
Purchased or originated credit-impaired				
Credit-impaired	–	–	1	–
Total	4,814	20,350	2,584	20,785

The Group Loan commitments and financial guarantees	2019 Loans and advances to customers £m	2018 Loans and advances to customers £m
Stage 1		
Good quality	16,599	16,209
Satisfactory quality	122	281
Lower quality	–	56
Below standard, but not credit-impaired	–	–
	16,721	16,546
Stage 2		
Good quality	–	–
Satisfactory quality	–	–
Lower quality	1	–
Below standard, but not credit-impaired	–	–
	1	–
Stage 3		
Credit-impaired	–	–
Purchased or originated credit-impaired		
Credit-impaired	–	–
Total	16,722	16,546

35 Financial risk management (continued)

The Bank Gross carrying amount	2019 Loans and advances to banks £m	2019 Loans and advances to customers £m	2018 Loans and advances to banks £m	2018 Loans and advances to customers £m
Stage 1				
Good quality	**4,788**	**19,342**	2,562	16,031
Satisfactory quality	**–**	**414**	–	665
Lower quality	**–**	**3**	–	153
Below standard, but not credit-impaired	**5**	**–**	–	–
	4,793	**19,759**	2,562	16,849
Stage 2				
Good quality	**–**	**–**	–	–
Satisfactory quality	**–**	**4**	–	–
Lower quality	**–**	**15**	–	–
Below standard, but not credit-impaired	**–**	**–**	–	–
	–	**19**	–	–
Stage 3				
Credit-impaired	**–**	**293**	–	277
Purchased or originated credit-impaired				
Credit-impaired	**–**	**–**	–	–
Total	**4,793**	**20,071**	2,562	17,126

The Bank Loan commitments and financial guarantees	2019 Loans and advances to customers £m	2018 Loans and advances to customers £m
Stage 1		
Good quality	**16,539**	15,029
Satisfactory quality	**122**	281
Lower quality	**–**	56
Below standard, but not credit-impaired	**–**	–
	16,661	15,366
Stage 2		
Good quality	**–**	–
Satisfactory quality	**–**	–
Lower quality	**1**	–
Below standard, but not credit-impaired	**–**	–
	1	–
Stage 3		
Credit-impaired	**–**	–
Purchased or originated credit-impaired		
Credit-impaired	**–**	–
Total	**16,662**	15,366

35 Financial risk management (continued)

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

The Group and 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
Asset-backed securities:						
Mortgage-backed securities	74	–	74	–	–	–
Other asset-backed securities	2	–	2	132	–	132
	76	–	76	132	–	132
Corporate and other debt securities	36	–	36	–	–	–
Gross exposure	112	–	112	132	–	132
Allowance for impairment losses	–	–	–	–	–	–
Total debt securities held at amortised cost	112	–	112	132	–	132

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

2 Other comprises sub-investment grade £nil for the Group and £nil for the Bank (2018: £nil for the Group and £nil for the Bank) and not rated £nil for the Group and £nil for the Bank (2018: £nil for the Group and £nil for the Bank).

Financial assets at fair value through other comprehensive income
An analysis of financial assets at fair value through other comprehensive income is included in note 17. The credit quality of financial assets at fair value through other comprehensive income is set out below:

The Group and 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
Debt securities						
Government securities	–	–	–	–	–	–
Bank and building society certificates of deposit	97	–	97	118	–	118
Asset-backed securities:						
Mortgage-backed securities	–	–	–	121	–	121
Other asset-backed securities	121	–	121	–	73	73
	121	–	121	121	73	194
Corporate and other debt securities	–	–	–	18	–	18
Total debt securities	218	–	218	257	73	330
Treasury and other bills	96	–	96	82	–	82
Total financial assets at fair value through other comprehensive income	314	–	314	339	73	412

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

2 Other comprises sub-investment grade £nil for the Group and £nil for the Bank (2018: £nil for the Group and £nil for the Bank) and not rated £nil for the Group and £nil for the Bank (2018: £73 million for the Group and £73 million for the Bank).

35 Financial risk management (continued)

Debt securities, treasury and other bills held at fair value through profit or loss
An analysis of financial assets at fair value through profit or loss is included in note 12. The credit quality of debt securities, treasury and other bills held at fair value through profit or loss is set out below.

	2019			2018		
The Group	**Investment grade[1] £m**	**Other[2] £m**	**Total £m**	Investment grade[1] £m	Other[2] £m	Total £m
Trading assets						
Government securities	**6,501**	**–**	**6,501**	4,898	–	4,898
Bank and building society certificates of deposit	**–**	**–**	**–**	–	–	–
Asset-backed securities:						
Mortgage-backed securities	**1**	**5**	**6**	10	–	10
Other asset-backed securities	**14**	**3**	**17**	43	–	43
	15	**8**	**23**	53	–	53
Corporate and other debt securities	**232**	**1**	**233**	205	26	231
Total held as trading assets	**6,748**	**9**	**6,757**	5,156	26	5,182
Other assets mandatorily at fair value through profit or loss						
Government securities	**–**	**–**	**–**	–	–	–
Bank and building society certificates of deposit	**68**	**–**	**68**	59	–	59
Corporate and other debt securities	**1**	**–**	**1**	–	–	–
Total debt securities mandatorily at fair value through profit or loss	**69**	**–**	**69**	59	–	59
Treasury and other bills	**19**	**–**	**19**	20	–	20
Total other assets mandatorily at fair value through profit or loss	**88**	**–**	**88**	79	–	79
	6,836	**9**	**6,845**	5,235	26	5,261
Due from fellow Lloyds Banking Group undertakings: Corporate and other debt securities	**40**	**–**	**40**	–	–	–
Total held at fair value through profit or loss	**6,876**	**9**	**6,885**	5,235	26	5,261

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

2 Other comprises sub-investment grade £1 million (2018: £nil) and not rated £8 million (2018: £26 million).

35 Financial risk management (continued)

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
Trading assets						
Government securities	**6,501**	**–**	**6,501**	4,898	–	4,898
Bank and building society certificates of deposit	**–**	**–**	**–**	–	–	–
Asset-backed securities:						
Mortgage-backed securities	**1**	**5**	**6**	10	–	10
Other asset-backed securities	**14**	**3**	**17**	43	–	43
	15	**8**	**23**	53	–	53
Corporate and other debt securities	**232**	**1**	**233**	205	26	231
Total held as trading assets	**6,748**	**9**	**6,757**	5,156	26	5,182
Other assets mandatorily at fair value through profit or loss						
Government securities	**–**	**–**	**–**	–	–	–
Bank and building society certificates of deposit	**–**	**–**	**–**	–	–	–
Corporate and other debt securities	**1**	**–**	**1**	–	–	–
Total debt securities mandatorily at fair value through profit or loss	**1**	**–**	**1**	–	–	–
Treasury and other bills	**–**	**–**	**–**	–	–	–
Total other assets mandatorily at fair value through profit or loss	**1**	**–**	**1**	–	–	–
	6,749	**9**	**6,758**	5,156	26	5,182
Due from fellow Lloyds Banking Group undertakings: Corporate and other debt securities	**40**	**–**	**40**	–	–	–
Total held at fair value through profit or loss	**6,789**	**9**	**6,798**	5,156	26	5,182

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

2 Other comprises sub-investment grade £1 million (2018: £nil million) and not rated £8 million (2018: £26 million).

Derivative assets

An analysis of derivative assets is given in note 13.

The Group and the Bank 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 £18,836 million (2018: £15,867 million) for the Group, cash collateral of £3,776 million (2018: £3,143 million) for the Group was held and a further £153 million (2018: £119 million) for the Group was due from OECD banks.

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
Trading and other	**15,256**	**831**	**16,087**	12,091	838	12,929
Hedging	**15**	**–**	**15**	–	–	–
	15,271	**831**	**16,102**	12,091	838	12,929
Due from fellow Lloyds Banking Group undertakings			**2,734**			2,938
Total derivative financial instruments			**18,836**			15,867

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

2 Other comprises sub-investment grade £602 million (2018: £638 million) and not rated £229 million (2018: £200 million).

35 Financial risk management (continued)

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
Trading and other	**15,257**	**831**	**16,088**	12,091	838	12,929
Hedging	**14**	**–**	**14**	–	–	–
	15,271	**831**	**16,102**	12,091	838	12,929
Due from fellow Lloyds Banking Group undertakings			**2,790**			2,992
Total derivative financial instruments			**18,892**			15,921

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

2 Other comprises sub-investment grade £602 million (2018: £638 million) and not rated £229 million (2018: £200 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

There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £1,148 million for the Group and the Bank (2018: £2,583 million for the Group and the Bank), against which the Group and the Bank held collateral with a fair value of £1,128 million (2018: £1,179 million for the Group and the Bank).

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

Loans and advances to customers

Commercial lending

Reverse repurchase transactions

At 31 December 2019 there were reverse repurchase agreements which were accounted for as collateralised loans with a carrying value of £2,976 million for the Group and the Bank (2018: £4,604 million for the Group and the Bank) against which the Group and the Bank held collateral with a fair value of £2,583 million (2018: £3,143 million for the Group and the Bank) all of which the Group was able to repledge. No collateral in the form of cash was provided in respect of reverse repurchase agreements to the Group or the Bank in 2019 and 2018. These transactions were generally conducted under terms that are usual and customary for standard secured lending

Stage 3 secured lending

At 31 December 2019, stage 3 secured commercial lending amounted to £216 million, net of an impairment allowance of £77 million for the Group and the Bank (2018: impaired secured commercial lending amounted to £275 million, net of an impairment allowance of £23 million for the Group and £259 million, net of an impairment allowance of £17 million for the Bank). The fair value of the collateral held in respect of stage 3 secured commercial lending was £nil (2018: £nil).

Financial assets at fair value through profit or loss

Included in financial assets at fair value through profit or loss are reverse repurchase agreements treated as collateralised loans with a carrying value of £10,935 million for the Group and the Bank (2018: £11,669 million). Collateral is held with a fair value of £10,733 million for the Group and the Bank, all of which the Group is able to repledge (2018: £11,669 million for the Group and the Bank). At 31 December 2019, £8,627 million had been repledged (2018: £13,994 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £8,154 million (2018: £6,178 million) for the Group and the Bank.

Of this amount, £7,616 million (2018: £5,531 million) has been resold or repledged as collateral for the Group and Bank's own transactions.

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

Derivatives 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 agreements of £10,153 million for the Group (2018: £8,343 million) and £10,209 million for the Bank (2018: £8,343 million), cash collateral of £4,483 million (2018: £3,663 million) for the Group and the Bank was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2019, the Group held irrevocable loan commitments and other credit-related contingencies of £16,912 million (2018: £nil) and the Bank held irrevocable loan commitments and other credit-related contingencies of £16,851 million (2018: £nil).

35 Financial risk management (continued)

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 balances arising from repurchase transactions of £nil for the Group and the Bank (2018: £nil for the Group and the Bank); the fair value of the collateral provided under these agreements at 31 December 2019 was £nil for the Group and the Bank (2018: £nil for the Group and the Bank).

Customer deposits

Included in customer deposits are balances arising from repurchase transactions of £nil for the Group and the Bank (2018: £372 million for the Group and the Bank); the fair value of the collateral provided under these agreements at 31 December 2019 was £nil for the Group and the Bank (2018: £372 million for the Group and the Bank).

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

The fair value of collateral pledged in respect of repurchase transactions, accounted for as secured borrowing, where the secured party is permitted by contract or custom to repledge was £8,324 million for the Group and the Bank (2018: £nil for the Group and the Bank).

Securities lending transactions

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

The Group and the Bank	2019 £m	2018 £m
Financial assets at fair value through profit or loss	**3,348**	945
Financial assets at fair value through other comprehensive income	**253**	892
Total	**3,601**	1,837

(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.

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 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 LBCM Asset and Liability Committee.

The Group and the Bank establish 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 £4,126 million for the Group and Bank (2018: £5,366 million for the Group and Bank) with a net fair value asset of £2 million (2018: £nil). There were gains recognised on the hedging instruments of £143 million for the Group and Bank (2018: £50 million for the Group and Bank). There were losses on the hedged items attributable to the hedged risk of £147 million for the Group and Bank (2018: £46 million for the Group and Bank). The gains and losses relating to the fair value hedges are recorded in net trading income.

In addition the Group has 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 £10,844 million for the Group and Bank (2018: £1,998 million for the Group and Bank) with a net fair value asset of £7 million (2018: £nil). Ineffectiveness recognised in the income statement that arises from cash flow hedges was a gain of £4 million for the Group and Bank (2018: £nil for the Group and Bank).

35 Financial risk management (continued)

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
– 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 has designated into cash-flow hedge relationships that is directly affected by the interest rate benchmark reform is £2,428 million, of which £1,971 million relates to Sterling LIBOR. These are principally loans and advances to customers in Commercial Banking. In addition, the interest rate benchmark reforms affect assets designated in fair value hedges with a notional of £500 million, of which £500 million is in respect of sterling LIBOR. These fair value hedges principally relate to debt securities in issue. There are no fair value hedges of assets affected.

The Group is managing the process to transition to alternative benchmark rates under an LBG-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
– 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 hedging instruments in hedging relationships to which these amendments apply was £14,970 million, of which £500 million relates to Sterling LIBOR fair value hedges and £9,522 million relates to Sterling LIBOR cash flow hedges.

Currency risk
The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All nonstructural 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's main overseas operations are in the USA, Europe and Singapore. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

	2019		2018	
The Group and the Bank	**US Dollar £m**	**Other non-sterling £m**	US Dollar £m	Other non-sterling £m
Exposure	**101**	**–**	69	1

(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 weekly 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.

35 Financial risk management (continued)

The tables below analyse financial instrument liabilities of the Group and the Bank 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
31 December 2019						
Deposits from banks	**294**	**261**	**514**	**2,924**	**–**	**3,993**
Customer deposits	**17,531**	**2,993**	**2,466**	**1,392**	**117**	**24,499**
Derivative financial instruments	**9,729**	**999**	**972**	**1,135**	**415**	**13,250**
Trading and other financial liabilities at fair value through profit or loss	**4,310**	**5,473**	**1,959**	**1,383**	**1,440**	**14,565**
Debt securities in issue	**1,534**	**2,174**	**6,084**	**3,487**	**–**	**13,279**
Other liabilities (lease liabilities)	**–**	**1**	**3**	**33**	**56**	**93**
Subordinated liabilities	**–**	**–**	**–**	**–**	**698**	**698**
31 December 2018						
Deposits from banks	1	304	143	588	2,141	3,177
Customer deposits	19,749	3,264	2,521	253	1,083	26,870
Derivative financial instruments	1,686	768	1,057	2,191	8,809	14,511
Trading and other financial liabilities at fair value through profit or loss	3,286	6,689	2,725	685	623	14,008
Debt securities in issue	1,182	1,698	2,746	5,556	1,760	12,942
Subordinated liabilities	725	–	–	–	–	725

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
31 December 2019						
Deposits from banks	**294**	**261**	**514**	**2,924**	**–**	**3,993**
Customer deposits	**17,102**	**2,984**	**2,437**	**1,390**	**117**	**24,030**
Derivative financial instruments	**9,729**	**999**	**972**	**1,135**	**415**	**13,250**
Trading and other financial liabilities at fair value through profit or loss	**4,310**	**5,473**	**1,959**	**1,383**	**1,440**	**14,565**
Debt securities in issue	**1,534**	**2,174**	**6,084**	**3,487**	**–**	**13,279**
Other liabilities (lease liabilities)	**–**	**–**	**1**	**23**	**46**	**70**
Subordinated liabilities	**–**	**–**	**–**	**–**	**698**	**698**
31 December 2018						
Deposits from banks	1	304	142	588	2,141	3,176
Customer deposits	8,161	2,909	1,842	184	1,084	14,180
Derivative financial instruments	1,686	768	1,056	2,191	8,809	14,510
Trading and other financial liabilities at fair value through profit or loss	3,286	6,689	2,725	685	623	14,008
Debt securities in issue	1,182	1,698	2,746	5,556	1,760	12,942
Subordinated liabilities	725	–	–	–	–	725

35 Financial risk management (continued)

The following tables set out the amounts and residual maturities of off balance sheet contingent liabilities and commitments.

The Group	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
31 December 2019					
Acceptances and endorsements	**33**	**24**	**–**	**–**	**57**
Other contingent liabilities	**123**	**15**	**128**	**–**	**266**
Total contingent liabilities	**156**	**39**	**128**	**–**	**323**
Lending commitments and guarantees	**2,498**	**4,858**	**9,067**	**280**	**16,703**
Other commitments	**1**	**17**	**1**	**–**	**19**
Total commitments and guarantees	**2,499**	**4,875**	**9,068**	**280**	**16,722**
Total contingents, commitments and guarantees	**2,655**	**4,914**	**9,196**	**280**	**17,045**
31 December 2018					
Acceptances and endorsements	117	46	–	–	163
Other contingent liabilities	140	48	114	–	302
Total contingent liabilities	257	94	114	–	465
Lending commitments and guarantees	21	–	–	–	21
Other commitments	1,818	5,208	9,113	386	16,525
Total commitments and guarantees	1,839	5,208	9,113	386	16,546
Total contingents, commitments and guarantees	2,096	5,302	9,227	386	17,011

The Bank	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
31 December 2019					
Acceptances and endorsements	**33**	**24**	**–**	**–**	**57**
Other contingent liabilities	**123**	**15**	**128**	**–**	**266**
Total contingent liabilities	**156**	**39**	**128**	**–**	**323**
Lending commitments and guarantees	**2,498**	**4,858**	**9,007**	**280**	**16,643**
Other commitments	**1**	**17**	**1**	**–**	**19**
Total commitments and guarantees	**2,499**	**4,875**	**9,008**	**280**	**16,662**
Total contingents, commitments and guarantees	**2,655**	**4,914**	**9,136**	**280**	**16,985**
31 December 2018					
Acceptances and endorsements	117	46	–	–	163
Other contingent liabilities	140	48	114	–	302
Total contingent liabilities	257	94	114	–	465
Lending commitments and guarantees	–	–	–	–	–
Other commitments	1,686	4,639	8,658	383	15,366
Total commitments and guarantees	1,686	4,639	8,658	383	15,366
Total contingents, commitments and guarantees	1,943	4,733	8,772	383	15,831

36 Capital disclosures

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 and stressed ratios reviewed by the LBCM 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).

36 Capital disclosures (continued)

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 (0.5 per cent of risk-weighted assets as at 31 December 2019).

For capital the Group has adopted the IFRS 9 transitional arrangements 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 capital relief under the transitional arrangements has been recognised by the Group.

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 capital represents the strongest form of capital consisting of shareholders' equity after a number of regulatory adjustments and deductions are applied. These include the elimination of the cash flow hedging reserve and the debit valuation adjustment and the accrual for forseeable dividends
- 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
- Tier 2 (T2) capital comprises certain other subordinated debt securities that do not qualify as AT1. They must have an original term of at least 5 years, cannot normally be redeemed within their first 5 years and are phased out as T2 regulatory capital in the final 5 years before maturity

The Group's capital resources are summarised as follows:

	2019 £m	2018 £m
Common equity tier 1 capital	**2,331**	2,723
Additional tier 1 capital	**757**	757
Tier 2 capital	**645**	672
Total capital	**3,733**	4,152

37 Notes to the Cash flow statement

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	**123**	(6,275)	**(2,018)**	(5,894)
Changes in amounts due to fellow Lloyds Banking Group undertakings	**5,883**	6,206	**4,304**	(1,388)
Change in derivative financial instruments and financial assets at fair value	**(3,866)**	(9,852)	**(3,860)**	(9,908)
Change in other operating assets	**422**	(913)	**424**	(933)
Change in operating assets	**2,562**	(10,834)	**(1,150)**	(18,123)

37 Notes to the Cash flow statement (continued)

b Change in operating liabilities

	The Group		The Bank	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Change in deposits from banks	**793**	3,177	**794**	3,176
Change in customer deposits	**(2,391)**	13,964	**(1,065)**	14,007
Changes in amounts due to fellow Lloyds Banking Group undertakings	**(156)**	(540)	**(4,610)**	6,501
Change in derivative financial instruments and financial liabilities at fair value	**3,027**	12,942	**3,028**	12,942
Change in debt securities in issue	**(513)**	5,192	**(513)**	5,191
Change in other operating liabilities	**76**	(100)	**37**	99
Change in operating liabilities[1]	**836**	34,635	**(2,329)**	41,916

1 Includes £65 million (2018: £nil) for the Group and £48 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	**19**	2	**11**	2
Dividends received from subsidiary undertakings	**–**	–	**(811)**	–
Impairment of subsidiary undertaking	**–**	–	**640**	–
Foreign exchange element on balance sheet[1]	**(1)**	2	**(1)**	–
Other non-cash items	**–**	5	**3**	15
Non-cash and other items	**18**	9	**(158)**	17

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.

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	**16,250**	14,448	**16,250**	14,441
Less: mandatory reserve deposits[1]	**(111)**	(12)	**(111)**	(12)
	16,139	14,436	**16,139**	14,429
Loans and advances to banks	**4,813**	2,583	**4,792**	2,561
Less: amounts with a maturity of three months or more	**(1,858)**	(1,541)	**(1,858)**	(1,540)
	2,955	1,042	**2,934**	1,021
Total cash and cash equivalents	**19,094**	15,478	**19,073**	15,450

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.

38 Events since the balance sheet date

The risks arising from the outbreak of Coronavirus (Covid-19) which has occurred since the balance sheet date are disclosed on page 5. In view of its currently evolving nature, the Directors are unable to estimate its financial effect.

39 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 intial application being recognised at that date; comparative information has therefore not been restated. Comparative information was prepared in accordance with 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 £88 million. Lease liabilities accounting to £72 million in respect of leased properties previously accounting 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, adjusted to excluded short-term leases and leases of low-value assets of approximately £nil. The weighted-average borrowing rate applied to these lease liabilities was 2.43 per cent. The corresponding right-of-use asset of £72 million was measured at an amount equal to the lease liabilities, adjusted for lease liabilities recognised at 31 December 2018 of £nil. 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.

40 Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2019 and have not been applied in preparing these financial statements. Save as disclosed below, the impact of these accounting changes is still being assessed by the Group and reliable estimates cannot be made at this stage.

With the exception of certain minor amendments, as at the date of signing these financial statements these pronouncements have been endorsed by the EU.

Minor amendments to other accounting standards
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.

41 Ultimate parent undertaking and controlling party

Lloyds Bank Corporate Markets 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 overseas.

Lloyds Bank Corporate Markets plc's immediate parent undertaking and 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.

42 Subsidiaries and related undertakings

In compliance with Section 409 of the Companies 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 percentage of the class(es) of shares held by the Group. All shares held are ordinary shares unless indicated otherwise in the notes.

The Bank directly or indirectly holds 100 per cent of the share class and a majority of voting rights in the following undertakings.

Subsidiary undertakings	Bank interest	Registered Address
Black Horse Offshore Limited	100.00%	11-12 Esplanade, St Helier, Jersey JE4 8ZU
Lloyds America Securities Corporation	100.00%[a]	1095 Avenue of the America's, 34th Floor, New York, NY 10036, United States
Lloyds Bank (International Services) Limited[c]	100.00%	11-12 Esplanade, St Helier, Jersey JE2 3QA
Lloyds Bank Corporate Asset Finance (No.1) Limited	100.00%	25 Gresham Street, London EC2V 7HN
Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH	100.00%	Thurn-Und, Frankfurt Am Main, 60313, Germany
Lloyds Bank International Limited	100.00%	11-12 Esplanade, St Helier, Jersey JE2 3QA
Lloyds Corporate Services (Jersey) Limited	100.00%	11-12 Esplanade, St Helier, Jersey JE2 3QA
Lloyds Holdings (Jersey) Limited	100.00%	11-12 Esplanade, St Helier, Jersey JE2 3QA
Lloyds Investment Fund Managers Limited	100.00%	11-12 Esplanade, St Helier, Jersey JE2 3QA
Lloyds Nominees (Guernsey) Limited	100.00%	Sarnia House, Le Truchot, St. Peter Port, Guernsey, GY1 4EF
Lloyds Securities Inc.	100.00%[b]	1095 Avenue of the America's, 34th Floor, New York, NY 10036, United States
Nominees (Jersey) Limited	100.00%	11-12 Esplanade, St Helier, Jersey JE2 3QA

Notes

a. 10,000 US$ No par value

b. 10 US$ 0.1% common

c. On 29 March 2019 Lloyds Bank (Gibraltar) Limited re-domiciled to Jersey and change its name to Lloyds Bank (International Services) Limited.

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